(9)

No. 95-325-CFX
Status: GRANTED

Title: United States, Petitioner
v.
Reorganized CF&I Fabricators of Utah, Inc., et al.

Docketed:
August 24, 1995

Court: United States Court of Appeals for the Tenth Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: McCardell,Steven J.

Entry	Date	Note	Proceedings and Orders
1	Jul 12 1995	G	Application (A95-35) to extend the time to file a petition for a writ of certiorari from July 26, 1995 to August 25, 1995, submitted to Justice Breyer.
2	Jul 14 1995		Application (A95-35) granted by Justice Breyer extending the time to file until August 25, 1995.
3	Aug 24 1995	G	Petition for writ of certiorari filed.
4	Sep 27 1995		DISTRIBUTED. October 13, 1995 (Page 3)
5	Sep 28 1995	X	Brief of respondents Reorganized CF&I Fabricators of Utah, Inc., et al. in opposition filed.
6	Nov 1 1995		REDISTRIBUTED. November 22, 1995 (Page 1)
7	Nov 7 1995	X	Reply brief of petitioner filed.
10	Nov 27 1995		REDISTRIBUTED. December 1, 1995 (Page 19)
11	Dec 1 1995		Petition GRANTED. The case is set for oral argument in tandem with No. 95-323, United States v. Thomas R. Noland, Trustee for Debtor First Truck Lines, Inc. **
12	Dec 14 1995	G	Motion of the Solicitor General to dispense with printing the joint appendix filed.
13	Jan 8 1996		Motion of the Solicitor General to dispense with printing the joint appendix GRANTED.
14	Jan 16 1996		Brief of petitioner United States filed.
15	Jan 16 1996		Brief amicus curiae of Pension Benefit Guaranty Corporation filed.
16	Jan 24 1996		SET FOR ARGUMENT MONDAY, MARCH 25, 1996. (2ND CASE).
17	Jan 29 1996		CIRCULATED.
18	Feb 7 1996		Record filed.
		*	Partial record proceedings United States Court of Appeals for the Tenth Circuit (BOX)
19	Feb 20 1996	G	Motion of United Steelworkers of America, AFL-CIO for leave to file a brief as amicus curiae filed.
20	Feb 20 1996	X	Brief of respondents Reorganized CF&I Fabricators of Utah, Inc., et al. filed.
21	Mar 4 1996		Motion of United Steelworkers of America, AFL-CIO for leave to file a brief as amicus curiae GRANTED.
22	Mar 7 1996		Record filed.
		*	Certified record proceedings United States District Court for the District of Utah.
23	Mar 15 1996	X	Reply brief of petitioner United States filed.
24	Mar 25 1996		ARGUED.

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No. 95-325

In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORADO & UTAH LAND COMPANY, REORGANIZED KANSAS METALS COMPANY, REORGANIZED ALBUQUERQUE METALS COMPANY, REORGANIZED PUEBLO METALS COMPANY, REORGANIZED PUEBLO RAILROAD SERVICE COMPANY, REORGANIZED DENVER METALS COMPANY, REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORPORATION, AND REORGANIZED COLORADO AND WYOMING RAILWAY COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the claim of the United States against the debtor in bankruptcy for an excise tax owed under Section 4971(a) of the Internal Revenue Code, 26 U.S.C. 4971(a), is entitled to the distributive priority for an "excise tax" provided by Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E) (1988).[1]

2. Whether, in the absence of inequitable conduct by the government in obtaining or enforcing its claim, the excise tax claim of the United States under Section 4971(a) of the Internal Revenue Code may be subordinated to general unsecured claims under the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code, 11 U.S.C. 510(c).[2]

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[1] Section 304(c) of the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4132, added a new seventh priority for alimony and child support claims and changed the preexisting priority for excise taxes from seventh to eighth. Those amendments have no significance for the issues presented in this case.

[2] A closely analogous question concerning the proper scope of the "principles of equitable subordination" in bankruptcy cases is presented in *United States* v. *Noland*, 48 F.3d 210 (6th Cir. 1995). We are concurrently filing a petition for a writ of certiorari in that case. Because of the closeness of the issues presented in these two cases, we suggest that both petitions be granted and that the cases be set for argument in tandem.

We have furnished a copy of the petition in *United States* v. *Noland* to counsel for the respondents in this case. We have also furnished a copy of the petition in this case to the respondent in *United States* v. *Noland*.

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In the Supreme Court of the United States

OCTOBER TERM, 1995

No.

UNITED STATES OF AMERICA, PETITIONER

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORADO & UTAH LAND COMPANY, REORGANIZED KANSAS METALS COMPANY, REORGANIZED ALBUQUERQUE METALS COMPANY, REORGANIZED PUEBLO METALS COMPANY, REORGANIZED PUEBLO RAILROAD SERVICE COMPANY, REORGANIZED DENVER METALS COMPANY, REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORPORATION, AND REORGANIZED COLORADO AND WYOMING RAILWAY COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-9a) is reported at 53 F.3d 1155. The opinion of the district court (App., *infra*, 10a-11a) is unre-

ported. The opinion of the bankruptcy court (App., *infra*, 38a-62a) is reported at 148 B.R. 332.

JURISDICTION

The judgment of the court of appeals was filed on April 27, 1995. On July 14, 1995, Justice Breyer extended the time for filing a petition for a writ of certiorari to and including August 25, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant portions of Sections 507(a)(7) and 510(c) of the Bankruptcy Code, 11 U.S.C. 507(a)(7) and 510(c) (1988), and of Section 4971 of the Internal Revenue Code, 26 U.S.C. 4971, are set forth in the Appendix, *infra*, at 63a-66a.

STATEMENT

1. Respondents are the CF&I Steel Corporation and its nine wholly owned subsidiaries. Prior to 1990, these corporations maintained defined-benefit pension plans for their employees that were subject to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 *et seq.* For the year that ended on December 31, 1989, respondents failed to make required pension plan contributions of $12,400,000. The plans therefore had an "accumulated funding deficiency" equal to that amount. See 26 U.S.C. 412(a). In November 1990, respondents filed petitions for reorganization under Chapter 11 of the Bankruptcy Code (App., *infra*, 2a).

Subtitle D of the Internal Revenue Code is entitled "Miscellaneous Excise Taxes." One of the provisions

of that subtitle—Section 4971(a) of the Internal Revenue Code—imposes a 10 percent excise tax on the amount of any "accumulated funding deficiency" of qualified pension plans. 26 U.S.C. 4971(a). The excise tax liability for respondents' "accumulated funding deficiency" under Section 4971(a) was therefore approximately $1,240,000. The Internal Revenue Service filed proofs of claims for that amount in respondents' bankruptcy case (App., *infra*, 2a-3a).[3]

The government's proofs of claim assert that the liability for this excise tax under Section 4971(a) of the Internal Revenue Code is entitled to seventh priority in the distribution of the assets of the debtors' estates under Section 507(a)(7)(E) of the Bankruptcy Code.[4] As applicable to this case, Section

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[3] The proofs of claim filed by the United States also asserted (i) priority claims for excise taxes under Section 4971(a) for the subsequent plan year, (ii) priority claims for excise taxes under Section 4971(b) for both the 1989 and 1990 plan years, (iii) nonpriority claims for penalties related to the Section 4971(a) excise tax for 1989 and (iv) priority claims for income taxes for various years. Section 4971(b) of the Internal Revenue Code imposes an additional excise tax, equal to 100 percent of the "accumulated funding deficiency," on employers who fail to correct the deficiency within a specified period. 26 U.S.C. 4971(b). The government did not appeal the adverse rulings relating to those claims.

[4] The Pension Benefit Guaranty Corporation (PBGC) also filed proofs of claim in this case. The PBGC guarantees payment of certain vested benefits under terminated pension plans. See 29 U.S.C. 1301 *et seq.* The PBGC obtains funds for that purpose from insurance premiums paid by the employers whose pension plans are subject to Title IV of ERISA. See 29 U.S.C. 1306. In March 1992, when one of the debtors' pension plans was terminated, the PBGC became the statu-

507(a)(7)(E) provides a "[s]eventh" priority for governmental claims for any "excise tax" that arose during the three years immediately preceding the date of the filing of the bankruptcy petition. See 11 U.S.C. 507(a)(7)(E)(i) and (ii) (1988); note 1, *supra*. Section 507(a)(7)(G) of the Bankruptcy Code provides the same "[s]eventh" priority to a statutory penalty that is "related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss." 11 U.S.C. 507(a)(7)(G) (1988).

Respondents filed an objection to the government's claim. They argued that the excise tax claims under Section 4971(a) were neither a "tax" nor a penalty compensating for pecuniary loss and should therefore be denied any priority under Section 507 of the Bankruptcy Code.

2. The bankruptcy court allowed the government's claim under Section 4971(a) of the Internal Revenue Code but denied that claim any priority under Section 507(a)(7)(E) of the Bankruptcy Code. The court recognized (App., *infra*, 47a-48a) that, in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (6th Cir. 1991), cert. denied, 502 U.S. 1092

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tory trustee for the plan pursuant to 29 U.S.C. 1342. The PBGC thereby became liable to plan participants for guaranteed benefits.

The PBGC filed proofs of claim in the bankruptcy case seeking to recover unpaid pension plan contributions. The PBGC also sought to recover its own statutory claims for unfunded benefits. The bankruptcy court concluded that most of the PBGC's claims were unsecured and had no priority in distribution of the assets of the estates. The district court upheld those rulings. *PBGC* v. *Reorganized CF&I Fabricators of Utah, Inc.*, 179 B.R. 704 (D. Utah 1994).

(1992), the Sixth Circuit held that the excise tax imposed by Section 4971(a) must be given priority in bankruptcy. In *Mansfield Tire*, the court reasoned that, since Congress denominated Section 4971 as an excise tax and further expressly provided that claims for excise taxes have priority in bankruptcy under Section 507(a)(7)(E), the plain language of the statutes must be followed without regard to the underlying "purpose" served by the tax. 942 F.2d at 1059. The bankruptcy court, however, rejected the Sixth Circuit's ruling as "unnecessarily rigid" (App., *infra*, 48a). The court stated that the fact that Congress denominated the tax imposed by Section 4971 as an excise tax should be disregarded in applying the Section 507(a)(7)(E) priority provision, for "blind acceptance of the label would defeat the purpose of the Bankruptcy Code" (App., *infra*, 49a).

The court concluded that allowing a priority for the excise tax imposed under Section 4971(a) would be anomalous for several reasons. First, the court expressed concern that priority treatment of the excise tax claim would elevate that claim above the PBGC's claims for the underlying funding deficiency (App., *infra*, 51a; see note 4, *supra*). Second, the court stated that, because bankruptcy courts may independently review state and local exactions to determine whether they represent a priority "tax" or a non-priority penalty, a failure similarly to review federal exactions would result in a "disparate treatment" that "the Bankruptcy Code does not contemplate" (App., *infra*, 51a). Third, the court stated that payment of priority excise tax claims would burden respondents' efforts to reorganize, would diminish the return to other creditors and would give

a "windfall" to the government (*ibid.*). Fourth, because the priority excise tax claims would be paid before the claims of the pensioners themselves, the court stated that the excise tax priority would harm the very parties that Section 4971 was intended to protect (*ibid.*). For these reasons, the court concluded that it must be "empowered, under the circumstances of this case, to look behind the characterization of the exaction set forth in the statute and focus on the actual nature of the claims" (*id.* at 52a).

The bankruptcy court applied what it termed the *Lorber Industries* "test" to determine the "actual nature" of the tax (App., *infra*, 52a). That test derives from *County Sanitation District No. 2* v. *Lorber Industries of California, Inc.*, 675 F.2d 1062 (9th Cir. 1982), which was a bankruptcy case involving collection of a county sewer use fee. The Ninth Circuit held in that case that the following four elements characterize a "tax," as distinguished from a user fee, for purposes of determining entitlement to priority under the former Bankruptcy Act:

> (a) An involuntary pecuniary burden, regardless of name, laid upon individuals or property;
>
> (b) Imposed by or under authority of the legislature;
>
> (c) For public purposes, including the purposes of defraying expenses of government or undertakings authorized by it;
>
> (d) Under the police or taxing power of the state.

675 F.2d at 1066. In the present case, the bankruptcy court concluded, under "its own independent application" of the *Lorber* standard, that the excise tax

imposed under Section 4971(a) is not a "tax" but is in the nature of a penalty and is therefore not entitled to priority under Section 507(a)(7) of the Bankruptcy Code (App., *infra*, 52a).

3. The United States appealed to the district court. While that appeal was pending, respondents issued a proposed plan of reorganization. The United States objected to the proposed plan because it failed to make provision for payment of the Section 4971(a) excise tax in the event that the United States prevailed on its appeal of the priority issue. The bankruptcy court nonetheless confirmed the plan. The United States appealed from the order of confirmation.

In the meantime, respondents initiated an adversary proceeding in their bankruptcy case, seeking to subordinate the Section 4971(a) excise tax claims to the claims of general unsecured creditors. Respondents relied on Section 510(c) of the Bankruptcy Code, which authorizes bankruptcy courts to apply "principles of equitable subordination [to] subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim." 11 U.S.C. 510(c). Respondents contended that the "principles of equitable subordination" permit the court to subordinate claims for "penalties" even if the holder of the claim has not engaged in any inequitable conduct. The bankruptcy court agreed with respondents and ordered the Section 4971(a) excise tax claim to be "subordinated to the claims of all other general unsecured creditors of the Debtors pursuant to 11 U.S.C. § 510(c)" (App., *infra*, 21a). The United States appealed that order.

4. a. Twelve days after the bankruptcy court issued its original order denying priority to the Section

4971(a) tax, the Tenth Circuit issued its decision in *United States* v. *Dumler*, 983 F.2d 161 (1992). That case involved the bankruptcy priority of the government's claim for the 10 percent "additional tax" imposed under Section 72(t) of the Internal Revenue Code upon early distributions from qualified retirement plans. The question in *Dumler* was whether that "additional tax" (26 U.S.C. 72(t)) is a "tax on or measured by income" that is entitled to seventh priority in bankruptcy under 11 U.S.C. 507(a)(7)(A). The Tenth Circuit held in *Dumler* that, although Section 72(t) purports to impose a "tax," it in fact imposes a "penalty" for a nonpecuniary loss and therefore has no priority in bankruptcy.[5] 983 F.2d at 164-165. In reaching that conclusion, the Tenth Circuit stated that it rejected the reasoning of the Sixth Circuit in *Mansfield Tire* and held that it could "recharacterize for purposes of bankruptcy what Congress has deemed a tax in the Internal Revenue Code." 983 F.2d at 162, citing *In re Unified Control Systems, Inc.*, 586 F.2d 1036 (5th Cir. 1978).

b. In the present case, the district court consolidated the government's appeals from the orders of the bankruptcy court that (i) denied priority to the Section 4971(a) claim, (ii) confirmed the plan of reorganization and (iii) subordinated the Section 4971(a) claim to the claims of all general unsecured creditors. The district court affirmed all three orders, reasoning that the Section 4971(a) excise tax "is

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[5] The question whether the doctrine of equitable subordination would permit subordination of such a claim to all other general unsecured claims was not presented in *United States* v. *Dumler*.

a nonpecuniary loss penalty, not a tax" (App., *infra*, 18a). The court stated that equitable subordination of the government's claim is appropriate "primarily" for the reasons set forth in the Tenth Circuit's opinion in the *Dumler* case (App., *infra*, 18a). But see note 5, *supra*.

5. The court of appeals affirmed (App., *infra*, 1a-9a). Relying on its previous decision in *Dumler*, the court held that the name that Congress gives an exaction under the Internal Revenue Code does not determine its status in applying the priority provisions of Section 507(a)(7) of the Bankruptcy Code. The court stated that whether an exaction is a "tax" or a "penalty" for purposes of bankruptcy priority is to be determined by application of the four-part test of *Lorber Industries* (App., *infra*, 6a). Under this test, the court concluded that the Section 4971(a) excise tax is in substance a "penalty," rather than a "tax," "for substantially the reasons given by the bankruptcy court" (App., *infra*, 6a).

The court then addressed the equitable subordination of the government's claim. The court first noted that, "[b]ecause we have determined that the [claim of the United States in this case] is a nonpecuniary loss penalty not entitled to section 507 priority," the court had no reason to consider whether a claim that *is* entitled to priority under Section 507 may be subordinated to other claims under the "principles of equitable subordination" (App., *infra*, 6a).[6] The

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[6] Whether a "case-by-case" balancing of the "equities" may be applied to subordinate a claim that the court believes to be "unfair" to other creditors even when Congress has expressly designated such a claim as a priority claim in Section 507 of the Bankruptcy Code—a question that the court of appeals

court then acknowledged that equitable subordination historically has been imposed only when a creditor has engaged in wrongful conduct and that "the bankruptcy court expressly found that 'there [had] been no inequitable conduct on the part of the Internal Revenue Service'" in this case (App., *infra*, 6a, 7a). The court stated, however, that in codifying the "principles of equitable subordination" in Section 510(c) of the Bankruptcy Code, "Congress intended courts to continue developing" those principles (App., *infra*, 7a). The court reasoned that the "developing" principles of equitable subordination permit a court (*id.* at 8a, quoting *In re Virtual Network Services Corp.*, 902 F.2d 1246, 1250 (7th Cir. 1990)):

> to equitably subordinate claims to other claims on a case-by-case basis without requiring in every instance inequitable conduct on the part of the creditor claiming parity among other unsecured general creditors.

In particular, the court held that these developing "principles of equitable subordination" do "not require a finding of claimant misconduct to subordinate nonpecuniary loss tax penalty claims" (App., *infra*, 8a, citing *e.g.*, *Burden* v. *United States*, 917 F.2d 115, 116-120 (3d Cir. 1990); *Schultz Broadway Inn* v. *United States*, 912 F.2d 230, 231-234 (8th Cir. 1990)).

Turning to "the equities in this case" (App., *infra*, 8a), the court held that subordination is appropriate because the PBGC and other "general unsecured creditors of CF&I will receive only a small percent-

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asserted that it was not required to reach in this case—was addressed and answered affirmatively in *United States* v. *Noland*, *supra*. See note 2, *supra*.

age of their claims" and [d]eclining to subordinate the [excise tax claim of the United States] would harm innocent creditors rather than punish the debtor for failing to fund the pension plan" (*ibid.*).

REASONS FOR GRANTING THE PETITION

This case presents two closely related questions of substantial recurring importance. The first concerns whether the statutory priority for an "excise tax" is available only if the underlying purpose of the excise tax is to raise revenue rather than discourage conduct. Both the plain language and the clear history of Section 507(a)(7)(E) of the Bankruptcy Code reflect that the priority that Congress granted to "excise taxes" is not conditioned on a finding that the excise tax is primarily designed to raise revenues. As the court of appeals acknowledged (App., *infra*, 4a, 48a; see *United States* v. *Dumler*, 938 F.2d at 162), its decision on this issue directly conflicts with the contrary decision of the Sixth Circuit in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059. The proper scope of the statutory priority for "excise tax" claims under Section 507(a)(7)(E) of the Bankruptcy Code is frequently litigated and often involves substantial sums. Absent further review by this Court, the conflicting understandings of Section 507(a)(7)(E) that the courts of appeals have adopted will engender wasteful litigation and result in disparate treatment of otherwise identical claims.

The second question presented in this case concerns whether, under the judge-made "principles of equitable subordination" that Congress codified in Section 510(c) of the Bankruptcy Code, a bankruptcy court may subordinate the claim of a creditor who has

not acted in an inequitable or wrongful manner. By assuming an authority to subordinate the claim of an innocent creditor in order to prefer the claim of other creditors who have *not* been granted priority by Congress, the decision in this case conflicts with the established rule that "principles of equitable subordination" do *not* permit a court to make "abstract legislative judgments about the fairness of a result contemplated by the legislature's statutory scheme if it has otherwise been followed in good faith and without overreaching." *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d 784, 787 (9th Cir.), cert. denied, 423 U.S. 913 (1975). In applying the doctrine of "equitable subordination" to subordinate the claim of an innocent creditor, the decision in this case broadens an existing conflict among the courts of appeals. The authority that the court assumed to engage in a "case-by-case" analysis of what is "fair" in the distribution of a debtor's assets loosens the doctrine of "equitable subordination" from its established moorings; it also threatens to disrupt the ordinary enforcement not only of excise taxes but of other types of tax and private claims as well.

1. a. The court of appeals erred in holding that the excise tax imposed by Section 4971(a) of the Internal Revenue Code is not entitled to the priority that Congress expressly provided for an "excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code. Congress enacted Section 4971 of the Internal Revenue Code as part of the Employee Retirement Income Security Act of 1974 (ERISA). In connection with the qualified pension plan arrangements authorized by ERISA, Section 4971 was enacted to "impose[] an excise tax on the employer if he fails to fund the plan at the minimum required amounts." H.R. Rep. No. 807, 93d Cong., 2d Sess. 97 (1974).

Even before the Bankruptcy Code was enacted in 1978, Congress thus expressly designated the tax imposed by Section 4971 as an "excise tax" (*ibid.*; see also S. Rep. No. 383, 93d Cong., 1st Sess. 24, 33, 70 (1973)). Section 4971 was placed within Subtitle D of the Internal Revenue Code—which is entitled "Miscellaneous Excise Taxes"—precisely because Congress understood and intended that Section 4971 *is* an "excise tax" (H.R. Rep. No. 807, *supra*, at 97).

When the Bankruptcy Code was enacted, one of the changes that it made to the provisions of the former Bankruptcy Act was the new, express specification of a priority for "excise tax" claims. Compare 11 U.S.C. 507(a)(7)(E) (1988) with 11 U.S.C. 104(a) (1976). The joint floor statements that accompanied enactment of the Bankruptcy Code in 1978 described the intended scope of this specific "excise tax" priority:

> All Federal, State, or local taxes *generally considered or expressly treated as excises* are covered by this category, including sales taxes, estate and gift taxes, gasoline and special fuel taxes, and wagering and truck taxes.

124 Cong. Rec. 32,416 (1978) (Rep. Edwards) (emphasis added); *id.* at 33,998, 34,016 (Sen. DeConcini) (same).

Since Congress "expressly treated" the excise tax created under Section 4971 of the Internal Revenue Code as an "excise tax" even before the Bankruptcy Code was enacted, the Sixth Circuit correctly concluded in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059, that this tax is entitled to the priority established by Section 507(a)(7)(E). As this Court stated in *United States* v. *Ron Pair Enter-*

prises, Inc., 489 U.S. 235 (1989), when the language of the Bankruptcy Code is plain, "the sole function of the courts is to enforce it according to its terms." *Id.* at 241, quoting *Caminetti* v. *United States*, 242 U.S. 470, 485 (1917). While resort to the legislative history of these provisions is therefore unnecessary, that history leaves no room for any different conclusion.

In particular, the court of appeals erred in concluding that an "excise tax" that exacts a "penalty" is not an "excise tax" within the meaning of Section 507(a)(7)(E) of the Bankruptcy Code. As the Sixth Circuit explained in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059, Congress expressly granted priority to any "excise tax" without adding any limitation based upon the "purpose" of the tax. Moreover, Congress clearly understood that an excise tax is no less an "excise tax" because it has a regulatory or punitive purpose. Excise taxes in the Internal Revenue Code are often imposed on disfavored activities and are often designed to discourage or punish undesirable conduct. See, *e.g.*, 26 U.S.C. 4064 (gas guzzler tax), 4681 (Supp. V 1993) (tax on ozone-depleting chemicals), 4701 (tax on "registration-required" obligations issued in bearer form), 4911 (tax on excess lobbying by public charities), 4941 *et seq.* (tax on undistributed income and speculative investments of private foundations), 4955 (tax on political expenditures by Section 501(c)(3) organizations), 4981 and 4982 (taxes on undistributed income of real estate investment trusts and regulated investment companies), 4999 (tax on "golden parachute" payments), 5881 (tax on "greenmail"). If Congress had intended to exclude so many federal excise taxes from the excise tax priority, one would expect to find some indication to that effect in the Bankruptcy Code or in its legislative history. Instead, the legislative history specifies that the priority for excise taxes comprehensively includes "[a]ll [f]ederal, [s]tate or local taxes generally considered or expressly treated as excises" (124 Cong. Rec. at 32,416 (Rep. Edwards) (listing the excise tax on "wagering" as one example).

The text of the Bankruptcy Code provides further evidence that Congress intentionally omitted any distinction among excise taxes in enacting the priority for such taxes in Section 507(a)(7)(E). In Section 507(a)(7)(G), Congress expressly drew a distinction among different types of tax-related *penalties* and established a priority only for such penalties that are "in compensation for actual pecuniary loss" (11 U.S.C. 507(a)(7)(G)). As this Court has observed, "it is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another" (*City of Chicago* v. *Environmental Defense Fund*, 114 S. Ct. 1588, 1593 (1994), quoted in *BFP* v. *Resolution Trust Corp.*, 114 S. Ct. 1757, 1761 (1994)). That presumption is especially appropriate when, as here, language conditioning an express priority is used in one paragraph and omitted in another paragraph of the same subsection of the statute. If Congress intended to exclude from the priority for "excise taxes" any excise tax that might be "punitive" rather than "compensatory," it surely knew how to do so. Instead, it deliberately chose *not* to do so.

b. The four-part *Lorber Industries* standard on which the court of appeals relied (see page 9, *supra*) has no proper application in this context.

That test was formulated by the Ninth Circuit to determine whether an exaction that a State describes as a priority "tax" is instead a non-priority user fee. See 675 F.2d at 1066. Whatever relevance that analysis may have in determining whether an exaction is a "tax" for purposes of the bankruptcy priority for a "tax on or measured by income" (11 U.S.C. 507(a)(7)(A)), it has no relevance in determining whether an exaction is an "excise tax" under Section 507(a)(7)(E).[7] As both the legislative history of

[7] *United States* v. *Dumler*, 983 F.2d at 163-164, concerned whether the challenged exaction was a "tax on or measured by income" for purposes of the priority established in Section 507(a)(7)(A) of the Bankruptcy Code. The court of appeals did not attempt in this case to explain why the analysis of that decision should be applied in determining whether an exaction is an "excise tax" under the more specific provisions of Section 507(a)(7)(E) of the Code. As we describe in the text, an "excise tax" is often, if not ordinarily, designed to accomplish regulatory or punitive objectives, as well as raising revenue.

This Court's decisions in *City of New York* v. *Feiring*, 313 U.S. 283 (1941), and *New Jersey* v. *Anderson*, 203 U.S. 483 (1906), on which the court of appeals relied in *United States* v. *Dumler*, 983 F.2d at 163, involved whether state and local exactions constituted "taxes" for purposes of priority for taxes under the former Bankruptcy Act. As the Sixth Circuit noted in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1060, although it is appropriate carefully to review the designation of state and local exactions to insure that such claims are not improperly promoted within the federal priority scheme, courts are not free to recast an exaction that Congress has designated as a "tax" to be something else. In *A. Magnano Co.* v. *Hamilton*, 292 U.S. 40, 43 (1934), this Court stated that whether an exaction is for the public purpose of raising revenues turns on "the use which is to be made of the revenue derived from the tax, and not [on] any ulterior motive or purpose which may have influenced the legislature in passing the act." In any event, for the reasons we have explained, cases involving a general priority for "taxes" are not relevant in determining the scope of the more specific priority for "excise taxes" under Section 507(a)(7)(E).

that Section and its plain text reflect, the priority for an "excise tax" applies to all such exactions "generally considered *or* expressly treated as excises" (124 Cong. Rec. at 32,416) (Rep. Edwards) (emphasis added). The plain text of the Bankruptcy Code should not have been disregarded by the court of appeals. See, *e.g.*, *Patterson* v. *Shumate*, 504 U.S. 753, 757-759 (1992); *Connecticut National Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992); *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. at 242.

c. As the court of appeals recognized, the decision in this case directly conflicts with the decision of the Sixth Circuit in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059-1060. The question addressed in these conflicting decisions—whether bankruptcy courts may deny the statutory priority for taxes based upon a perceived punitive purpose of the tax—is frequently litigated and often involves substantial sums. Compare *United States* v. *Unsecured Creditors' Committee of C-T of Virginia, Inc.*, 977 F.2d 137 (4th Cir. 1992) (the 10 percent tax for withdrawals from a qualified pension plan is a priority "excise tax," not a penalty), cert. denied, 113 S. Ct. 1644 (1993), with *United States* v. *Dumler*, 983 F.2d at 162 (the 10 percent tax under Section 72(t) is a non-priority "penalty"), and *In re Unified Control Systems, Inc.*, 586 F.2d at 1037-1038 (a tax that is a "penalty" is not entitled to priority). See also *In re Juvenile Shoe Corp. of America*, 166 B.R. 404 (Bankr. 1994), rev'd, 180 B.R. 206 (E.D.

Mo. 1995), appeal pending, No. 95-2289 (8th Cir.); *Seidle* v. *United States*, 120 B.R. 597 (S.D. Fla. 1990); *United Steelworkers of America* v. *PBGC*, 103 B.R. 672 (Bankr. W.D. Pa. 1989). Absent resolution by this Court of this important recurring question, the existing conflict among the courts of appeals will produce repetitive and wasteful litigation that will result in disparate treatments of otherwise identical claims and debtors.

2. The court of appeals further erred in concluding that, under the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code, a bankruptcy court is to evaluate the "equities" of the claims of innocent creditors on a "case-by-case" basis to arrive at a distribution scheme that the court deems fair to all creditors (App., *infra*, 8a). In particular, the court erred in applying that rationale to subordinate the "penalty" claims of innocent creditors (*ibid.*). The expansive powers that the court has assumed under the doctrine of equitable subordination reflect a serious misapplication of that doctrine.

By enacting a specific set of statutory priorities, Congress has itself measured the "equities" of the various classes of claims. *Carpenter* v. *Wabash Ry.*, 309 U.S. 23, 28 (1940). Claims that Congress has placed within the same class are to be treated on identical terms. Equitable subordination does not authorize a court to "reweigh" the equities that Congress itself has already adjusted. As we explain in detail in the petition for a writ of certiorari in *United States* v. *Noland* (see note 2, *supra*), the doctrine of equitable subordination permits a court to subordinate a particular claim only if the claimant has acted inequitably in obtaining or enforcing its

claim, to the detriment of other creditors. See, *e.g.*, *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 787; *In re Columbia Ribbon Co.*, 117 F.2d 999, 1002 (3d Cir. 1941). The issue that is to be resolved under "principles of equitable subordination" is whether (2 Collier Bankruptcy Manual ¶ 510.01[1], at 510-2 (3d ed. 1995)):

> harmful conduct [of the claimant] was directed at other creditors. If it was, the claim which is otherwise provable and allowable should be postponed until the claims of the creditors, who were harmed, have been satisfied.

See *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211, 229 (1948); *Pepper* v. *Litton*, 308 U.S. 295, 311 (1939); *Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307, 323 (1939); *Benjamin* v. *Diamond*, 563 F.2d 692, 699 (5th Cir. 1977); Herzog & Zweibel, *The Equitable Subordination of Claims in Bankruptcy*, 15 Vand. L. Rev. 83, 85 (1961). As the Ninth Circuit held in *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 787:[8]

> [I]t is important to keep in mind that the chancellor never did, and does not now, exercise unrestricted power to contradict statutory or

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[8] Similarly, in *New Jersey* v. *Anderson*, 203 U.S. 483 (1906), this Court rejected the assertion that a statutory priority for state taxes should not be recognized because it created an "injustice" for other creditors and gave the State an undue "advantage" (*id.* at 490):

> [C]onsiderations of this character, however properly addressed to the legislative branch of the government, can have no place in influencing judicial determination. It is the province of the court to enforce, not to make the laws, and if the law works inequality the redress, if any, must be had from Congress.

> common law when he feels a fairer result may be obtained by application of a different rule. Courts of equity have long applied standards of conscience to conduct on an individual basis to prevent formally proper but unconscionable applications of legal rules; they have not engaged in the practice of making abstract legislative judgments about the fairness of a result contemplated by the legislature's statutory scheme if it has otherwise been followed in good faith and without overreaching.

By subordinating the statutory claims of innocent creditors for "nonpecuniary loss" penalties, the decision in this case reaches a result that is directly contrary to the statutory treatment that Congress enacted for such claims. In enacting the Bankruptcy Code, Congress considered and rejected a proposal to subordinate all "nonpecuniary loss" penalty claims under all chapters of the Code. *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. II at 115, § 4-406(a)(3) (1973). Instead, Congress provided for the subordination of "nonpecuniary loss" penalties only in Chapter 7 cases. See 11 U.S.C. 726(a)(4). In Chapter 11 cases, such as the present one, Congress left such penalties within the class of general unsecured claims. Through misapplication of the "principles of equitable subordination," however, the decision in the present case rejects and annuls that specific legislative determination.

The Sixth Circuit's invocation of the "principles of equitable subordination" to subordinate a first priority claim in *United States* v. *Noland*, 48 F.3d 210 (1995), and the Tenth Circuit's invocation of the same principles to subordinate what the court regarded as a general unsecured claim in the present case are closely related variants of the same error.[9] In both instances, the court substituted its judgment about the relative worthiness of a category of claims for the judgment that Congress made in enacting the Bankruptcy Code. In holding that a statutory "penalty" that was asserted in good faith and in compliance with law is to be subordinated to make the distribution to other creditors more "fair" than under the scheme that Congress enacted, the decision in this case simply disagrees with (and reaches a result precisely at odds with) the statutory scheme. As the Ninth Circuit stated in *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 788, the doctrine of equitable subordination does not permit a court to say, "in effect, * * * the distribution scheme provided by the [Bankruptcy] Act is a mistake."

In the petition for a writ of certiorari that we are filing concurrently in *United States* v. *Noland*, we describe the conflict that exists among the courts of appeals in their application of the "principles of equitable subordination." See note 2, *supra*. That petition also describes the substantial recurring importance of this question and the significant need for review by this Court of the recent decisions that have misapplied the doctrine of equitable subordination in bankruptcy cases. For the reasons set forth in that

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[9] In *United States* v. *Noland*, 48 F.3d at 210, the Sixth Circuit applied "principles of equitable subordination" to subordinate a claim that the court acknowledged was entitled to "[f]irst" priority under Section 507(a) of the Bankruptcy Code. In the present case, the Tenth Circuit applied "principles of equitable subordination" to subordinate a claim that the court erroneously held was *not* entitled to priority under Section 507(a)(7)(E) of the Code.

petition, and for the reasons stated above, the petitions in both cases should be granted. Because the two cases present related but different aspects of the same analytical issue, we suggest that the cases be set for argument in tandem.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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AUGUST 1995

APPENDIX A

[Filed Apr. 27, 1995]

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Nos. 94-4034
94-4035
94-4036

IN RE: CF&I FABRICATORS OF UTAH, INC., DEBTOR

UNITED STATES OF AMERICA, APPELLANT

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORATO & UTAH LAND COMPANY, REORGANIZED KANSAS METALS COMPANY, REORGANIZED ALBUQUERQUE METALS COMPANY, REORGANIZED PUEBLO METALS COMPANY, REORGANIZED PUEBLO RAILROAD SERVICE COMPANY, REORGANIZED DENVER METALS COMPANY, REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORPORATION, REORGANIZED THE COLORADO AND WYOMING RAILWAY COMPANY, APPELLEES

Appeal from the United States District Court
for the District of Utah

(D.C. No. 93-CV-68, 93-CV-317, 93-CV-424)

Before TACHA and HOLLOWAY, Circuit Judges, and BURRAGE,* District Judge.

TACHA, Circuit Judge.

I. Background

CF&I Fabricators of Utah, and various related entities (collectively, "CF&I") sponsored two qualified pension plans established for the benefit of their employees and retirees. Under the plans, CF&I was obligated to make annual plan funding contributions. On September 15, 1990, CF&I failed to make a required $12.4 million plan funding payment for the year ending December 31, 1989. Two months later, CF&I petitioned for reorganization under Chapter 11 of the Bankruptcy Code. The larger of the two pension plans was subsequently terminated by the Pension Benefit Guaranty Corporation ("PBGC"), a wholly-owned government corporation that guarantees payment of certain pension benefits. *See* 29 U.S.C. §§ 1321-1322b.[1]

The Internal Revenue Service ("IRS") filed several proofs of claim in the bankruptcy court. The claim that is the subject of this appeal arises under Internal Revenue Code ("IRC") section 4971(a),

* The Honorable Michael Burrage, District Judge, United States District Court for the Eastern District of Oklahoma, sitting by designation.

[1] Most of the funds from which the PBGC pays pension benefits come from insurance premiums paid by sponsors of qualified pension plans. *See* 29 U.S.C. § 1305. The PBGC filed proofs of claims against the debtors in the bankruptcy court. The bankruptcy court ruled that these claims are unsecured and are not entitled to priority or administrative status. That ruling is not at issue in this appeal.

under which the IRS imposes a ten percent tax on the "accumulated funding deficiency" of specified pension plans. 26 U.S.C. § 4971(a). CF&I's failure to make the required pension plan contribution on September 15, 1990, triggered the immediate imposition of the tax. *See id.* The parties do not dispute CF&I's underlying section 4971 liability. At issue is what, if any, priority the claim should be accorded.

In its proof of claim, the IRS asserted that CF&I's section 4971(a) liability was entitled to priority as an excise tax under Bankruptcy Code section 507(a)(7) (now codified at 11 U.S.C. § 507(a)(8)).[2] The bankruptcy court disagreed with the IRS's position and held that CF&I's section 4971(a) liability was not an excise tax. Instead, the court characterized the claim as a penalty that did not compensate for pecuniary loss and was therefore not entitled to priority status. *In re CF&I Fabricators*, 148 B.R. 332, 337-40 (Bankr. D. Utah 1992). In a subsequent order, the bankruptcy court subordinated the IRC section 4971(a) claim to all other general unsecured claims pursuant to the Bankruptcy Code's equitable subordination provision, 11 U.S.C. § 510(c)(1). The district court affirmed the bankruptcy court's orders, and the government appealed to this court. We have jurisdiction pursuant to 28 U.S.C. §§ 1-58(d) and 1291.

In its appeal, the IRS argues that the bankruptcy and district courts erred (1) by concluding that the

[2] Congress amended section 507 on October 22, 1994. Former subsection 507(a)(7) is currently located at subsection 507(a)(8). Other than the change in priority of governmental claims, the text of the subsection is unchanged. In this opinion we will refer to the provision as it was codified at the time the IRS asserted its claim.

exaction imposed by IRC section 4971(a) was not entitled to priority under section 507(a)(7), and (2) by subordinating the IRS's claim to all other unsecured creditors under the doctrine of equitable subordination. In addition, the government suggests that we reconsider, in an en banc hearing, our decision in *United States v. Dumler (In re Cassidy)*, 983 F.2d 161 (10th Cir. 1992).

II. Discussion

We review determinations of law by the bankruptcy court de novo. *Davidovich v. Welton (In re Davidovich)*, 901 F.2d 1533, 1536 (10th Cir. 1990). Our review of the district court's order affirming the bankruptcy court is de novo as well. *Burden v. United States (In re Burden)*, 917 F.2d 115, 116 (3d Cir. 1990).

A. *Priority Under Section 507(a)(7)*

The IRS contends that CF&I's section 4971(a) liability is a governmental claim entitled to priority under subsection 507(a)(7)(E) or, in the alternative, subsection 507(a)(7)(G). Section 507(a)(7)(E) accords priority to "an excise tax on . . . a transaction occurring before the date of the filing of the petition for which a return . . . is last due . . . after three years before the date of the filing of the petition." 11 U.S.C. § 507(a)(7)(E)(i). The same priority is accorded to "a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss." *Id.* § 507(a)(7)(G). The tax at issue here, IRC section 4971(a), is included in Subtitle D of the IRC, entitled "Miscellaneous Excise Tax." The IRS argues that, because the tax is

labeled an "excise tax" under the IRC, it must be considered an excise tax under the Bankruptcy Code as well.

On December 7, 1992, after the bankruptcy court issued its first order in this case, we decided *Cassidy*, 983 F.2d 161. In *Cassidy*, we held that "Congress' labeling of [an] exaction as a tax is not determinative of its status for priority in bankruptcy." *Id.* at 163. The tax at issue in *Cassidy* was the ten percent additional tax imposed by 26 U.S.C. § 72(t) on early distributions from qualified retirement plans. Section 72 is in subtitle A, chapter 1, subchapter B, part II of the IRC, which is titled "Items Specifically Included in Gross Income." Thus, the government argued, it should be given priority under section 507(a)(7)(A) as "a tax on or measured by income." We disagreed with the government and held that the label given a tax in the IRC was not determinative of its status for priority under section 507(a)(7). *Cassidy* further held that, to determine whether an exaction is a tax or penalty for priority in bankruptcy purposes, we apply the four-part test from *In re Lorber Indus.*, 675 F.2d 1062 (9th Cir. 1982). *Cassidy*, 983 F.2d at 163.

In the present case, the government vigorously argues that *Cassidy* was wrongly decided, again contending that a court should defer to Congress's designation of an exaction rather than look beyond the statutory label to the nature of the exaction. *Cassidy* binds this panel, however, because it is the law of this circuit. *See In re Smith*, 10 F.3d 723, 724 (10th Cir. 1993) (per curiam) ("We are bound by the precedent of prior panels absent en banc reconsideration or a superseding contrary decision by the Supreme Court."), *cert. denied*, 115 S. Ct. 53 (1994).

We therefore conclude that the bankruptcy court correctly refused to treat the IRC's label as determinative for priority in bankruptcy purposes.

Instead, the bankruptcy court looked beyond the IRC'c label and analyzed the nature of the exaction using the *Lorber* test. The court concluded that CF&I's section 4971(a) liability was not entitled to priority. We agree with the bankruptcy court's analysis and therefore affirm the order of the district court for substantially the reasons given by the bankruptcy court. *See In re CF&I Fabricators*, 148 B.R. 332.

B. *Equitable Subordination*

The government's first argument against equitable subordination of its claim is that a bankruptcy court may not subordinate a claim under section 510(c)(1) if that claim is entitled to priority under section 507. Because we have determined that the IRS's claim here is a nonpecunitry loss penalty not entitled to section 507 priority, we need not discuss the merits of this argument.

The government next contends that the phrase "under principles of equitable subordination" in section 510(c) prohibits the bankruptcy court from subordinating a claim without a finding of misconduct on the part of the subordinated claimant. In this case, the bankruptcy court expressly found that "there [had] been no inequitable conduct on the part of the Internal Revenue Service."

The Bankruptcy Code neither defines the doctrine of equitable subordination, *see United States v. Noland*, No. 93-4311, 1995 WL 82886, at *4 (6th Cir. Mar. 2, 1995), nor specifies the circumstances under

which it should be imposed, *see United States Abatement Corp. v. Mobil Exploration & Producing U.S., Inc. (In re United States Abatement Corp.)*, 39 F.3d 556, 561 (5th Cir. 1994). Consequently, courts applying section 510(c)(1) have looked to common law principles for guidance. *See, e.g., id.*

In general, equitable subordination is imposed only when a creditor has committed some kind of wrongful conduct. *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1248 (7th Cir. 1990); *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 700 (5th Cir. 1977). Nevertheless, the four circuit courts that have considered the matter have concluded that a court may subordinate a nonpecuniary loss tax penalty claim without a showing of misconduct on the part of the government. *See Noland*, 1995 WL 82886, at *8-9; *Burden*, 917 F.2d at 118-19; *Schultz Broadway Inn v. United States*, 912 F.2d 230, 234 (8th Cir. 1990); *In re Virtual Network*, 902 F.2d at 1249-50.[3]

The question was addressed first by the Seventh Circuit in *Virtual Network*. After a thorough analysis of the legislative history of section 510(c)(1), the court decided that Congress intended courts to continue developing the principles of equitable subordina-

[3] In addition, a number of district and bankruptcy courts have subordinated nonpecuniary loss tax penalties under section 510(c)(1). *See, e.g., In re Juvenile Shoe Corp. of Am.*, 166 B.R. 404, 410 (Bankr. E.D. Mo. 1994); *Walker v. Ferguson (In re Import & Mini Car Parts, Ltd.)*, 136 B.R. 178, 182 (Bankr. N.D. Ind. 1991); *Retail Marketing Corp. v. United States (In re Mako, Inc.)*, 135 B.R. 902, 904 (E.D. Okla. 1991); *Seidle v. United States (In re Airlift Int'l Inc.)*, 120 B.R. 597, 601-02 (S.D. Fla. 1990); *In re Merwede*, 84 B.R. 11, 14 (Bankr. D. Conn. 1988).

tion. *Virtual Network*, 902 F.2d at 1249-50. The court further found that "[section] 510(c)(1) authorizes courts to equitably subordinate claims to other claims on a case-by-case basis without requiring in every instance inequitable conduct on the part of the creditor claiming parity among other unsecured general creditors." *Id.* at 1250.

In subsequent cases addressing this issue, other courts have employed substantially the same analysis as the *Virtual Network* court. *See Noland*, 1995 WL 82886, at *3-8; *Burden*, 917 F.2d at 116-20; *Schultz Broadway Inn*, 912 F.2d at 231-34. We find the reasoning of *Virtual Network* persuasive and hold that section 510(c)(1) does not require a finding of claimant misconduct to subordinate nonpecuniary loss tax penalty claims.

The bankruptcy court considered the equities in this case and determined that subordination of the IRS's section 4971 claim to all other unsecured claims was appropriate. After noting that the facts in the case were undisputed, the bankruptcy court observed that general unsecured creditors of CF&I will receive only a small percentage of their claims. One of CF&I's unsecured creditors is the PBGC, which will be paying the pension benefits due under CF&I's terminated pension plan. Declining to subordinate the IRS's penalty claim would harm innocent creditors rather than punish the debtor for failing to fund the pension plan. Thus, the bankruptcy court reasoned, allowing the IRS's penalty claim would not advance the purposes of either IRC section 4971 or the Bankruptcy Code. We conclude that the bankruptcy court correctly addressed the equities in this case and therefore affirm the orders subordinating the IRS's section 4971 claims.

III. Conclusion

For the reasons stated in this opinion, the judgment of the district court is AFFIRMED. In addition, the government's suggestion for hearing en banc to reconsider our decision in *In re Cassidy*, 983 F.2d 161, has been brought to the attention of all the active judges of the court. As no poll has been requested on the suggestion, it is hereby DENIED.

APPENDIX B

[Filed Nov. 24, 1993]

THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

Consolidated Appeals
Civil No. 93C-068W
Civil No. 93C-317S
Civil No. 93C-424W

IN RE: CF&I FABRICATORS OF UTAH, INC., DEBTORS

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORADO & UTAH LAND CO., REORGANIZED KANSAS METALS CO., REORGANIZED ALBUQUERQUE METALS CO., REORGANIZED PUEBLO METALS CO., REORGANIZED PUEBLO RAILROAD SERVICE CO., REORGANIZED DENVER METALS CO., REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORP., REORGANIZED THE COLORADO AND WYOMING RAILWAY CO., PLAINTIFFS/APPELLEES

vs.

THE UNITED STATES OF AMERICA,
DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE, DEFENDANT/APPELLANT

ORDER

These appeals came on for oral argument before the Court on November 23, 1993. For the reasons stated by the Court in its findings and conclusions made on the record, which are incorporated herein, the decisions of the Bankruptcy Court which are the subject of these appeals are affirmed.

DATED this 23d day of November, 1993.

/s/ David K. Winder
DAVID K. WINDER
United States District Judge

APPROVED AS TO FORM:

/s/ Steven J. McCardell
STEVEN J. MCCARDELL

/s/ Kirk Lusty
KIRK LUSTY

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

Case No. 93-C-068W
93-C-317S
93-C-424W

REORGANIZED CF&I FABRICATORS OF UTAH, INC., REORGANIZED COLORADO & UTAH LAND CO., REORGANIZED KANSAS METALS CO., REORGANIZED ALBUQUERQUE METALS CO., REORGANIZED PUEBLO METALS CO., REORGANIZED PUEBLO RAILROAD SERVICE CO., REORGANIZED DENVER METALS CO., REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORP., REORGANIZED THE COLORADO AND WYOMING RAILWAY CO., PLAINTIFFS/APPELLEES

vs.

THE UNITED STATES OF AMERICA,
DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE, DEFENDANT/APPELLANT

TRANSCRIPT OF ARGUMENT ON
BANKRUPTCY APPEAL
BEFORE THE HONORABLE DAVID K. WINDER
UNITED STATES DISTRICT JUDGE
November 23, 1993

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[3] PROCEEDINGS

November 23, 1993

THE COURT: All right. We're here in these three consolidated appeals, and this is Number 93-C-68W, 93-C-317S and 93-C-424W. And this involves the debtor, which is Reorganized C.F.&I. Fabricators.

And, let's see, it's Mr. Waterman?

MR. McCARDELL: Mr. McCardell, Your Honor.

THE COURT: I'm sorry. Mr. Steven J. McCardell is here representing The Reorganized C.F.&I. Fabricators of Utah, and Mr. Kirk C. Lusty is here representing the U.S.A.

And I've read carefully your memos. I appreciate your being here on time. I've got to resume a jury trial at 9:00 o'clock, and I would ask you to take a maximum of 15 minutes a side.

I have read Judge Boulden's decision. I've read your memos carefully. I read the In Re Cassidy Tenth Circuit, the Mansfield case, and so I'm pretty familiar with what's involved here.

Mr. Lusty.

MR. LUSTY: Your Honor, I do realize you have a jury trial. And I realize, you know, I like you have several times read Cassidy and Mansfield Tire. We think the Mansfield Tire is the correct logic, but I realize the position the [4] court's in—

THE COURT: I don't overrule the Tenth Circuit. They ruled on 26(T), but there to me—what's the difference between the ten percent penalty on taking out your pension prematurely and 4791(A)?

MR. LUSTY: Well, the difference there, not talking about how broad the Cassidy opinion is, is that on the—on taking it out it's just a penalty for with-

drawal, and I thing pretty much you get into the legislative history and the statute, and at times they refer to it as a penalty, other times a tax.

Here it's—the pension excise, at least the first tier penalty, is always referred to as a tax. And basically when you fill out the form that's to accompany payment, you know, you look and what you haven't paid you list a ten percent penalty, almost like a—or ten percent tax I should say, much like, oh, on your income tax return, underreporting or underpayment, there's just a penalty.

It's associated with the return. It goes in different —for instance, you'll notice that in this appeal we don't, although Judge Boulden ruled against us, deal with the second tiered penalties, which are I think much more closer to penalties.

The first tier is, you know, reported on a return. It's figured, self-reported, that type of thing. There's —I.R.S. [5] is generally less involved in the audit assessment process with the first tier tax.

Before I go on with that, Your Honor, I guess the simplest way to proceed—because I do realize the time pressures on the court—Cassidy is a very broad opinion, and it doesn't purport to limit itself to the tax penalty that was raised in—in that particular case, a different penalty here, but it does specifically discuss Mansfield.

THE COURT: And rejects it.

MR. LUSTY: And rejects it. Is there anything I could convince or add to that that would help the court in that area.

THE COURT: I really don't. And to give you the bad news, Mr. Lusty, and I think you better get up to the circuit, if you're going there, pretty fast, because I denied the stay back in January. I guess

the reorganization, I don't know what's going on, but it seems to me if you're going to appeal this, you better do it quickly, and I notice Judge Boulden moved pretty swiftly in the bankruptcy court.

But Idon't see there's any distinguishing factor with Cassidy. Cassidy didn't rule on the 510(C) of the code, the equitable subordination thing, but I think frankly that follows, and I'm inclined to affirm the bankruptcy court.

MR. LUSTY: Okay. Let me, to enlighten that, discuss simply for a moment the equitable subordination issue, [6] because it is a very similar argument. Mansfield did, of course, involve equitable subordination, and Cassidy didn't; of course, Cassidy being a different type of tax didn't really need to get into that, or a much smaller amount.

And as we've discussed in our brief, the equitable subordination issue we submit early involved basically cases where there was credit or misconduct. Judge Boulden specifically stated in this case that there wasn't any.

Since in the last few years there have been cases, the virtual network and so forth, that have come down that at least have ruled or appear to rule that equitable misconduct is not the sole ground and you can do a—subordinate without equitable misconduct. We think, quite frankly, that they're misinterpreting the law, but nevertheless that's where they are.

We think the same distinction, and in light of Cassidy, there is some concern, but Cassidy didn't address it, that where it is a tax, that the subordination Moore is talking about penalties and so forth. And so that the court should make the same distinction as Mansfield Tire made and not subordinate

where it is a tax, and we think that's going further than the bankruptcy court should.

I realize that's very close to the same logic that Cassidy, if not the same logic, Cassidy rejected, but as we've set forth in our brief—

[7] THE COURT: You hadn't of course, read —the Tenth Circuit decided Cassidy December 7, of '92.

MR. LUSTY: Yes.

THE COURT: And you had read Judge Weinshank and Judge Clark, is it, in the bankruptcy court—

MR. LUSTY: In Colorado, yes.

THE COURT: But the Tenth Circuit opinion, of course, was not available to Judge Boulden when she decided that case.

MR. LUSTY: No. She had already decided. And I don't think, quite frankly, it would—obviously the same analysis she rejected and accepted, it seems like she essentially—you know, they're essentially the same. I don't want to take more of the court's time—

THE COURT: You're not taking my time. It's just you've got an uphill battle here, Mr. Lusty.

MR. LUSTY: I appreciate that.

THE COURT: I know you know that.

MR. LUSTY: Is there anything I can add on the subordination? Because that's it in a nutshell, that this is a tax, Congress has called it a tax—

THE COURT: I know.

MR. LUSTY: —and it should be not subordinated, and in this case that subordination essentially means the taxpayers bear the full brunt of this decision.

[8] I don't—really don't think there's anything I can add, unless—

THE COURT: Yes. You say the taxpayers bear the brunt. I mean this—I think this is a penalty. I don't know that the taxpayers are bearing any brunt. What's the reverse of this are these general creditors are going to take gas. I mean if you take 1,241,000 out of here, I guess there isn't a cent for anybody else.

MR. LUSTY: Well, in terms of this case, maybe, maybe not. Money has been set aside to pay other taxes if they're determined to be due; for instance, corporate income tax and others. And to the extent there will be—should be funds if—in the long-run if the United States were to prevail and happened to lose—particularly if it happened to lose on other taxes. In the long-run though if the United States gets it, I think it's fair to say that some other creditor wouldn't receive it—no question.

THE COURT: Thank you, Mr. Lusty, very much. Do you want to say anything, Mr. Mc Cardell?

MR. Mc CARDELL: Your Honor, I'm not one to argue myself out of court, and so I don't want to say anything Your Honor doesn't want to hear. I can answer your question with regard to Section 72(t) because that is a point of consideration since the Tenth Circuit did not directly rule on the 4971 tax.

[9] THE COURT: Yes. I think I said 4791—4971, and you're of course right.

MR. Mc CARDELL: The two points of distinction that the service raised in their brief are, number one, that the tax is self-assessing and, number two, that the notice of deficiency procedure applies to the Section 72(t) tax.

In reviewing those sections of the Internal Revenue Code though, Your Honor, it's apparent to me

that the same is true of the taxes ruled on in the Cassidy case. In other words, Section 72(t) is also self-assessing and the circuit's opinion said so, and this notice of deficiency procedures applies just the same. So that in substance we're dealing with the exact issue, and so I believe the service must seek their leave from the Supreme Court on this issue to get the law changed.

THE COURT: Okay, thank you. I affirm the Bankruptcy Court, and I hold that Section 4971(a) tax claim for 1989 is a nonpecuniary loss penalty, not a tax. It's not entitled to priority status pursuant to 507(A)(7) of the Bankruptcy Code, and I further hold that it's a claim that should be equitably subordinated to the claims of the general creditors under Section 510(c) of the code, and I do this primarily based on the In Re Cassidy case at 983 Fed. 2nd 161 decided by the Tenth Circuit last December.

Thank you very much. Prepare an order, Mr. Mc Cardell, and get it to me.

[10] MR. Mc CARDELL: I'll do that.

THE COURT: Thank you, gentlemen.

MR. LUSTY: Thank you.

(Hearing concluded at 8:40 a.m.)

APPENDIX D

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF UTAH CENTRAL DIVISION

Jointly Administered
Under Case No. 90B-6721

Chapter 11

Adversary Proceeding No. 92PB-2395

IN RE: CF&I FABRICATORS OF UTAH, INC., ET AL., DEBTORS

CF&I FABRICATORS OF UTAH, INC., ET AL., PLAINTIFFS

vs.

UNITED STATES OF AMERICA,
Department of the Treasury,
Internal Revenue Service, DEFENDANT

ORDER GRANTING DEBTORS' MOTION FOR SUMMARY JUDGMENT (DATED 12/22/92) AND SUBORDINATING ALL CLAIMS OF THE INTERNAL REVENUE SERVICE ARISING OUT OF 26 U.S.C. § 4971 TO ALL OTHER UNSECURED CLAIMS

The Debtors' Motion for Summary Judgment (Dated 12/22/92) (the "Motion") came on for hearing before the Court at 10:00 a.m. on Thursday, January 28, 1993. Steven C. Strong of LeBoeuf, Lamb, Leiby & MacRae appeared on behalf of CF&I Fabricators of Utah, Inc. and nine other related debtors whose bankruptcy cases are being jointly administered by this Court under Case No. 90B-6721 (collectively the "Debtors"). Steven T. Waterman of Ray, Quinney & Nebeker appeared on behalf of the Unsecured Creditors' Committee (the "Committee"). Mark Howard, Special Assistant United States Attorney, appeared on behalf of the Internal Revenue Service.

Having considered (i) the Motion, (ii) the Memorandum in Support of the Motion, (iii) the Memorandum of the United States in Opposition to the Motion, (iv) the Reply Memorandum in Support of the Motion, and (v) this Court's Order granting the Committee's intervention as a party plaintiff in this proceeding, the Court announced certain findings of fact and conclusions of law in open court (the "January 28th Ruling"), which Ruling is incorporated herein by this reference. Pursuant to the findings and conclusions contained in the January 28th Ruling.

IT IS HEREBY ORDERED AND ADJUDGED as follows:

1. The Debtors' Motion shall be and hereby is GRANTED, and judgment is entered in favor of the plaintiffs on all causes of action in the Debtors' Verified Complaint (except that, as requested in the Motion, the Court reserves judgment on that portion of the Complaint which seeks to subordinate claims to interests of CF&I Steel Corporation in its subsidiaries).

2. The claims of the IRS based on 26 U.S.C. § 4971(a) for the year ended December 31, 1989 and subsequent years are subordinated to the claims of all other general unsecured creditors of the Debtors pursuant to 11 U.S.C. § 510(c).

3. The claims of the IRS based on 26 U.S.C. § 4971(b) for the year ended December 31, 1989 and any subsequent years are subordinated to the claims of all other general unsecured creditors of the Debtors pursuant to 11 U.S.C. § 510(c).

4. The claims of the IRS for late payment penalties are subordinated to the claims of all other unsecured general creditors of the Debtors pursuant to 11 U.S.C. § 510(c).

DATED this 9 day of March, 1993.

BY THE COURT:

/s/ ______________________

HONORABLE JUDITH A. BOULDEN
United States Bankruptcy Judge

APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF UTAH CENTRAL DIVISION

Jointly Administered
Under Case No. 90B-6721

Chapter 11

IN RE: CF&I FABRICATORS OF UTAH, INC., ET AL., DEBTORS

(Case No. 90B-6721)
(Case No. 90B-6722)
(Case No. 90B-6723)
(Case No. 90B-6724)
(Case No. 90B-6725)
(Case No. 90B-6726)
(Case No. 90B-6727)
(Case No. 90B-6728)
(Case No. 90B-6729)
(Case No. 90B-6730)

(CF&I FABRICATORS OF UTAH, INC.) (COLORADO & UTAH LAND COMPANY) (KANSAS METALS COMPANY) (ALBUQUERQUE METALS COMPANY) (PUEBLO METALS COMPANY) (DENVER METALS COMPANY) (PUEBLO RAILROAD SERVICE COMPANY) (CF&I FABRICATORS OF COLORADO, INC.) (CF&I STEEL CORPORATION) (THE COLORADO AND WYOMING RAILWAY COMPANY)

ORDER CONFIRMING DEBTORS' AND RAILROAD TRUSTEE'S FIRST AMENDED AND RESTATED JOINT PLAN OF REORGANIZATION DATED DECEMBER 1, 1992

On January 27, 1993, the Court held a hearing to consider confirmation of the Debtors' and Railroad Trustee's First Amended and Restated Joint Plan of Reorganization dated December 1, 1992, a copy of which is attached to this Order as Exhibit 1 (the plan, together with the following modifications is referred to as the "Plan"), and the sale thereunder of those assets described in an Asset Purchase Agreement among Debtors (other than Kansas Metals Company), William J. Westmark, as trustee for the bankruptcy estate of The Colorado and Wyoming Railway Company (the "Railroad Trustee"), CF&I Steel, L.P. (formerly known as and identified in the Plan as New CF&I Limited Partnership), New CF&I, Inc., and Oregon Steel Mills, Inc. (a copy of the Asset Purchase Agreement is attached to the Plan as Exhibit B).

At the hearing, the Debtors and Railroad Trustee proposed the following modifications to the Plan and the Court determined pursuant to Bankruptcy Rule 3019 that the proposed modifications do not adversely change the treatment of the claim of any creditor or the interest of any equity security holder who has not accepted in writing the modification:

a. *Provisions concerning objection to Plan filed by IRS.*

i. Federal tax claims entitled to administrative priority must be filed by the Internal Revenue Serv-

ice ("IRS") not later than 180 days following the later of (1) the Effective Date or (2) the date a tax return is filed for a tax year or tax period. The IRS may request additional time to file any such claim as the Bankruptcy Court, for cause shown, permits; and

ii. Paragraphs 60 and 61 of the Plan shall not apply to any claims of the IRS against officers and directors for withholding taxes pursuant to section 6672 of the Internal Revenue Code; and

iii. Paragraph 61 of the Plan applies only to claims for which, pursuant to paragraph 60 of the Plan, indemnification obligations of the Debtors survive unaffected by the reorganization contemplated by the Plan; and

iv. Paragraph 70a(3)(iv) of the Plan (as reflected below in this Order) is modified to insert the words "for any Claims" in paragraph 70a(3)(iv) between the words "liability" and "by;" and

v. On the Effective Date, pursuant to the Plan's provisions for the treatment of Class 16, CF&I Steel Corporation's stock in each of its subsidiaries shall be canceled; and

vi. CF&I Steel Corporation shall, on the Effective Date of the Plan, pay to the United States Internal Revenue Service all amounts received after the date of the commencement of these cases by way of refunds of fuel excise taxes, and the United States Internal Revenue Service shall be authorized to apply such funds, plus any refunds of fuel excise taxes not distributed to CF&I Steel Corporation as of the Effective Date of the Plan, to post-petition alternative minimum tax claims of the Internal Revenue Service.

b. *Provisions concerning objection to Plan filed by Salt Lake County.* The Claim of Salt Lake County against CF&I Fabricators of Utah, Inc., which includes a secured claim for a penalty in the amount of $220.57, is an Allowed Secured Claim to be treated in Class 4 under the Plan.

c. *Provisions concerning objection to Plan filed by State of Colorado, Division of Labor.* Debtors shall continue payments in the ordinary course of their businesses, through the Effective Date on account of workers' compensation claims but, after the Effective Date, shall discontinue all such payments. With respect to Debtors with employees in Colorado, the Division of Labor of the State of Colorado shall designate, on or before the Effective Date, a successor administrator to receive delivery of documents and information concerning Debtors' present known, and potential Colorado workers' compensation claims, such administrator to administer said workers' compensation claims and to continue such payments thereon.

d. *Provisions concerning objection of Debtors to certain claims of PBGC.* Debtors' objections to the Claims of the Pension Benefit Guaranty Corporation as to the Non-Contributory Pension Plan of CF&I Steel Corporation shall be suspended pending the Debtors' and the Reorganization Debtors' implementation of Paragraph 56 of the Plan. Upon completion of a standard termination of the Non-Contributory Pension Plan of CF&I Steel Corporation in accordance with Section 4041(b) of ERISA, PBGC's Claims as to the Non-Contributory Pension Plan of CF&I Steel Corporation shall be deemed satisfied in full, and the Debtors objections thereto shall be deemed withdrawn. In the event the standard termi-

nation cannot be completed and the Debtors and the Reorganized Debtors decide to press the objection, they shall notify PBGC in writing and PBGC shall have thirty (30) days to respond.

e. *Provisions concerning Coastal Gas contract.* CF&I Steel Corporation shall have until the Effective Date to assume or reject its gas supply contract with Coastal Gas Marketing. The bar date for Coastal Gas Marketing to file any claims arising from any rejection of such contract shall be thirty (30) days after the Effective Date. If such contract is assumed, Coastal Gas Marketing shall have no remaining claim against the Debtors.

f. *Paragraph 70(a)(2) of Plan.* The conditions set forth in Paragraph 70a(2) of the Plan has been waived.

The Court then considered confirmation of the Plan as modified by paragraphs a through f above. Based on evidence presented at the hearing, the papers contained in the dockets of these cases on file with the Court, and the arguments of counsel, the Court made certain findings and conclusions on the record in addition to those findings and conclusions set forth below, which findings and conclusions are incorporated by this reference. Now, therefore, the Court finds as follows:

1. *Notice.* Notice of parties in interest of the time fixed for filing objections and the hearing to consider confirmation of the Plan has been given and is sufficient pursuant to applicable law. The solicitation package with respect to the Plan as approved by the Court was properly served on all necessary parties. Debtors have satisfied their obligations with respect to service of the solicitation package.

2. *Acceptance.* The balloting process on the Plan has been proper and the Plan has been accepted in writing by the creditors and equity security holders whose acceptance is required by law.

3. *Objections to Confirmation.* All objections to Confirmation, including without limitation those stated by way of letters to the Court, have been considered by the Court and have been overruled or withdrawn.

4. *Plan Conditions to Confirmation.* All conditions to Confirmation set forth in the Plan have been satisfied or effectively waived.

5. *Section 1129(a)(1).* The Plan complies with the applicable provisions of the Bankruptcy Code, including without limitation the provisions of the Bankruptcy Code respecting classification of Claims and the requirements of Bankruptcy Code section 1123. The Court specifically finds that Classes 1 and 11 are appropriate classes.

6. *Section 1129(a)(2).* The Plan Proponents have complied with the applicable provisions of the Bankruptcy Code.

7. *Section 1129(a)(3).* The Plan has been proposed in good faith and not by any means forbidden by law.

8. *Section 1129(a)(4).* All payments made or promised by the Debtors or by a person issuing securities or acquiring property under the Plan or by any other person for services or for costs and expenses in, or in connection with, the Plan and incident to the cases, have been fully disclosed to the Court and are reasonable or, if to be fixed after confirmation of the Plan, will be subject to approval of the Court.

9. *Section 1129(a)(5).* The identity, qualifications, and affiliations of the persons who are to be the directors or officers, or voting trustees, if any, of the Debtors after confirmation of the Plan have been fully disclosed, and the appointment of such persons to such offices, or their continuance therein, is equitable, and consistent with the interests of creditors and equity security holders and with public policy; and the identity of any insider that will be employed or retained by the Debtors and the nature of his compensation have been fully disclosed.

10. *Section 1129(a)(6).* The Plan does not propose any changes of rates under the jurisdiction of any regulatory commission and the rates of The Colorado and Wyoming Railway Company will continue to be regulated by such regulatory authorities as have jurisdiction under applicable nonbankruptcy law.

11. *Section 1129(a)(7) and Section 1129(a)(8).* Each holder of a claim or interest has accepted the Plan or will receive or retain under the Plan property of a value, as of the Effective Date of the Plan, that is not less than the amount that such holder would receive or retain if the Debtors were liquidated under Chapter 7 of the Bankruptcy Code on such date; or the Plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the Plan.

12. *Section 1129(a)(9).* Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the Plan satisfies the requirements of Bankruptcy Code Section 1129(a)(9) with respect to the payment of Claims having priority under Bankruptcy Code Section 507.

13. *Section 1129(a)(10).* For each Debtor, at least one class of claims that is impaired under the Plan has accepted the Plan, determined without including any acceptance of the Plan by any insider.

14. *Section 1129(a)(11).* Confirmation of the Plan is not likely to be followed by the liquidation or the need for further reorganization of the Debtors except as provided in the Plan.

15. *Section 1129(a)(12).* All fees payable under 28 USC § 1930, as determined by the Court at the hearing on confirmation of the Plan have been or will be paid on the Effective Date of the Plan.

16. *Section 1129(a)(13).* Class 1 and each subclass thereof have accepted the Plan. The level of retiree benefits has not been modified during the period of reorganization, and therefore subsections (e)(1)(B) and (g) of Section 1114 of the Bankruptcy Code have not been invoked and section 1129(a)(13) is not applicable.

17. *Section 1173(a).* With respect to The Colorado and Wyoming Railway Company,

a. All applicable requirements of Bankruptcy Code section 1129 have been met; and

b. Each creditor or equity security holder will receive or retain under the Plan property of a value, as of the Effective Date of the Plan, that is not less than the value of property that each such creditor or equity security holder would so receive or retain if all of the operating lines of the debtor were sold, and the proceeds of such sale, and the other property of the estate, were distributed under Chapter 7 of the Bankruptcy Code on such date; and

c. In light of the debtor's past earnings and the probable prospective earnings of the reorganized debtor, there will be adequate coverage by such pro-

spective earnings of any fixed charges, such as interest on debt, amortization of funded debt, and rent for leased railroads, provided for by the Plan; and

d. The Plan is consistent with the public interest.

18. *Sales of Assets under Asset Purchase Agreement.* Notice satisfying the provisions of Bankruptcy Code Section 363(b)(1) of the Bankruptcy Code that the Debtors and the Railroad Trustee intend to sell those assets described in the Asset Purchase Agreement, attached as Exhibit B to the Plan, was provided to all parties in interest on or about December 22 and 23, 1992, as part of the solicitation package sent to parties in interest.

19. *Clayton Act Notices.* Debtors have advised the Court that they have given all notices of the sale as required by subsection (a) of Section 7A of the Clayton Act in accordance with Bankruptcy Code Section 363(b)(2).

20. *Purchase Price and Satisfaction of Liens.* All entities which hold interests in the assets to be sold, other than the bankruptcy estates, are holders of liens and such entities will receive money in satisfaction of the interest that they hold therein; and the price at which the assets are to be sold is greater than the aggregate value of all liens on such assets. The purchase price provided in the Asset Purchase Agreement is fair consideration for the assets being purchased.

21. *Good Faith of Buyer.* The Buyer, as defined in the Asset Purchase Agreement, is a good faith purchaser within the meaning of Bankruptcy Code section 363(m).

NOW, THEREFORE, it is hereby
ORDERED:

1. *Approval of Modifications.* The modifications to Debtors' and Railroad Trustee's First Amended and Restated Joint Plan of Reorganization Dated December 1, 1992 proposed in paragraphs a through f above are approved.

2. *Confirmation of Plan.* Debtors' and Railroad Trustee's First Amended and Restated Plan of Reorganization, Dated December 1, 1992, as modified by this Order, is confirmed and all objections to the confirmation of the Plan are overruled.

3. *Authorizations for Asset Purchase Agreement.* Debtors and the Railroad Trustee are authorized to execute, deliver, and perform their respective obligations under an Asset Purchase Agreement in form substantially similar to the Asset Purchase Agreement attached as Exhibit B to the Plan as amended on January 27, 1993 and to execute any and all other documents and to take any and all actions necessary to complete the asset purchase and sale and upon its execution and delivery by all parties thereto, the Asset Purchase Agreement shall be valid, binding upon and enforceable against the Debtors and the Railroad Trustee.

4. *Authorizations for Implementation of Plan.* Debtors, the Reorganized Debtors, and the Railroad Trustee are authorized to execute any and all other documents and to take any and all actions necessary to implement the Plan.

5. *Retention of Property.* Except as otherwise expressly provided in this Order, each Debtor's estate shall retain all the property of its estate dealt with by the Plan free and clear of all Claims, liens, encumbrances, charges, and other interests of creditors and equity security holders, except as provided in the

Plan or this Order and each Debtor and Reorganized Debtor shall perform its obligations under the Plan.

6. *Transfers of Assets.* The transfers of assets pursuant to the Asset Purchase Agreement by the Debtors to CF&I Steel, L.P. (or such other entity purchasing such assets pursuant to the Asset Purchase Agreement or designated by CF&I Steel, L.P., to receive such assets), and pursuant to the Plan by the Debtors to Reorganized CF&I Steel Corporation when made (i) will be legal, valid and effective transfers of such assets; (ii) will vest CF&I Steel, L.P., or Reorganized CF&I Steel Corporation's estate or such other entity purchasing such assets pursuant to the Asset Purchase Agreement or the Plan with good title to such assets free and clear of all liens, charges, claims, encumbrances, or interests; (iii) do not and will not constitute fraudulent transfers or conveyances under the Bankruptcy Code or under the laws of the United States, any state, territory, possession or in the District of Columbia; (iv) will not subject Oregon Steel Mills, Inc., New CF&I, Inc., CF&I Steel, L.P. (or any of their affiliates) or Reorganized CF&I Steel Corporation to any liability for any Claims from any creditors of the Debtors and the Railroad Trustee, including, without limitation, any Claims under the Coal Industry Retiree Health Benefits Act of 1992 (including those filed or asserted by the 1992 United Mine Workers of America Benefit Plan and the United Mine Workers of America Combined Fund or the trustees thereof), by reason of such transfer under the laws of the United States, any state, territory, or possession thereof, or the District of Columbia based, in whole or in part, directly or indirectly, on any theory of law, including, without limitation, any theory of successor or transferee liability; and (v) all executory contracts, including, without limitation, product, patent, trademark, and know-how licenses and unexpired leases assumed by the Debtors and the Railroad Trustee during the Cases or under the Plan which are also assumed by CF&I Steel, L.P. pursuant to the Asset Purchase Agreement shall be assigned and transferred to, and remain in full force and effect for the benefit of, CF&I Steel, L.P., notwithstanding any provision in such contracts or leases (including those described in Sections 365(b)(2) and (f) of the Bankruptcy Code) that prohibit such assignment or transfer or that enables or requires termination of such contracts or leases based on the acquisition of assets pursuant to the terms of the Asset Purchase Agreement.

7. *Release.* Except as otherwise expressly provided in the Plan or in this Order, on the Effective Date all Persons (i) who have held, hold, or may hold Claims, or (ii) who have held, hold, or may hold CF&I Steel Corporation stock or stock of subsidiaries of CF&I Steel Corporation, in consideration for the obligations of the Debtors under the Plan, will be deemed to have forever waived, released, and discharged all rights or Claims, whether based upon tort, fraud, contract or otherwise, which they heretofore, now or hereafter possess or may possess against any of the Debtors.

8. *Injunction.* Except as otherwise expressly provided in the Plan or in this Order, all Persons who have held, or may hold Claims against or interests in any of the Debtors or liens against or interests in property of the Debtors or of any of the Debtors' estates are permanently enjoined on and after the Confirmation Date from taking any of the following

actions against the Debtors, the Railroad Trustee, the Reorganized Debtors, the Reorganized Creditors' Committee, CF&I Steel, L.P., New CF&I, Inc., or Oregon Steel Mills, Inc., or any of their officers, directors, agents, or affiliates or against any of the property of such entities with respect to such Claims or interests from: (a) commencing or continuing in any manner any action or other proceeding of any kind with respect to any such Claim or interest; (b) the enforcement, attachment, collection or recovery by any manner or means of any judgment, award, decree, or order; (c) creating, perfecting, or enforcing any lien or encumbrance of any kind; (d) asserting any setoff, right of subrogation, or recoupment of any kind against any obligation due to such entities; and (e) any act, in any manner, in any place whatsover, that does not conform to or comply with the provisions of the Plan.

9. *Validity of Sale Notwithstanding Reversal or Modification on Appeal.* The reversal or modification on appeal of the authorization to sell granted by this order shall not affect the validity of the sale under the Asset Purchase Agreement unless such authorization shall be stayed pending appeal.

10. *Claim of CF&I Steel, L.P. for Overpayment.* CF&I Steel, L.P. shall have a claim to any cash held by the Reorganized Debtors or the Railroad Trustee after the Effective Date for return of any overpayment as defined in Section 3.3(d) of the Asset Purchase Agreement. CF&I Steel, L.P.'s claim to such cash shall have a priority superior to all claims of general unsecured creditors in Classes 12, 13, and 14.

11. *VEBA Trust.* The VEBA Trust provided for in the Plan shall be established pursuant to a Trust

Agreement for CF&I Retiree Volunary Employees Beneficiary Association in substantially the form of Exhibit 10 received in evidence at the confirmation hearing, as modified during the hearing, and attached as part of Exhibit C to the Plan, which is attached as Exhibit 1 to this Order. On the Effective Date, pursuant to the Agreement for Substitution of Sponsors of the CF&I Retiree Voluntary Employee Beneficiary Association in substantially the form of Exhibit 11 received in evidence at the confirmation hearing and attached as part of Exhibit C to the Plan, which is attached as Exhibit 1 to this Order, CF&I Steel, L.P. shall succeed Debtors as sponsors of the CF&I Retiree Voluntary Employee Beneficiary Association, and the plan and trust established thereunder. The "Payment Recipient" identified in Section 3 of the Asset Purchase Agreement shall be the VEBA Trust provided for in the Plan.

12. *VEBA Trustees.* The initial trustees of the VEBA Trust provided for in the Plan shall be the following:

a. *Trustees selected by Debtors*: Robert W. Mac Cannon, Joan F. Vialpando, and Arthur L. Schwager.

b. *Trustees selected by the United Steelworkers of America*: Ray MacDonald, Dallas Alexander, and a representative of the Steelworker Organization of Active Retirees ("SOAR"), to be named by the United Steelworkers of America.

13. *Assumption, Assignment, and Rejection of Executory Contracts and Leases.* The assumption and assignment of those executory contracts and leases specified in Exhibit D to the Plan, a copy of which is attached to this Order as Exhibit 1, is ap-

proved and the rejection of all other executory contracts and leases as provided in the Plan is approved.

14. *Governance Provisions.* The provisions for governance of the Debtors and the Reorganized Debtors set forth in Exhibit 9 received in evidence at the confirmation hearing and attached as Exhibit 2 to this Order are hereby approved.

15. *Commitment Relating to Non-Contributory Pension Plan.* In order to effectuate the provisions of the Plan concerning the Non-Contributory Pension Plan of CF&I Steel Corporation, Debtors are authorized to enter into and make all commitments under the Agreement for Commitment to Make Plan Sufficient for Benefit Liabilities in substantially the form of Exhibit 3 to this Order.

16. *Distributions.* Distributions shall be made in the manner set forth in the Plan and as provided herein. As set forth in the Amended and Restated Agreement of Limited Partnership, the Pension Benefit Guaranty Corporation ("PBGC") shall be the limited partner of CF&I Steel, L.P. on the Effective Date of the Plan, with Debtors contributing partnership assets to CF&I Steel, L.P. on the Effective Date for the benefit of and on behalf of the PBGC in deemed distribution to it. Neither Debtors nor Reorganized Debtors shall be partners in CF&I Steel, L.P. The PBGC's limited partnership interest shall be subject to the obligation of PBGC to transfer all or such portion thereof as may be required in order to carry out the terms of the Plan, including to comply with the provisions of Paragraph 92 of the Plan and the provisions of the Plan for distributions to Class 12.

17. *Distribution of Certain Securities.* Distribution of the Deferred Stock Payment and the Five

Year Warrants (as those terms are defined in Section 3.1 of the Asset Purchase Agreement) to be delivered by Oregon Steel Mills, Inc., pursuant to the terms of the Asset Purchase Agreement, shall be made after the Effective Date, pursuant to an order of the Court, to the holders of any Allowed Claims entitled to such distributions under the Plan or as the Court may further order; provided, however, that Oregon Steel Mills, Inc., shall be obligated to issue the Deferred Stock Payment and the Five Year Warrants, only if the conditions in Section 10.15 of the Asset Purchase Agreement have been satisfied; and provided, further, that any such distribution shall comply with the provisions of Paragraph 92 of the Plan and the provisions of the Plan for distribution to Class 12, and shall take into account any transfer of the PBGC's limited partnership interest as may be required in the last sentence of the preceding paragraph 16 of this Order.

18. *Bar Dates Provided in Plan.* All bar dates provided in the Plan, as modified by this Order, shall be effective and Debtors shall give notice thereof with notice of this Order.

DATED: February 12, 1993.

/s/ Judith A. Boulden
JUDITH A. BOULDEN
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT COURT OF UTAH CENTRAL DIVISION

Jointly Administered Under
Under Case No. 90B-6721
[Chapter 11]

IN RE: CF&I FABRICATORS OF UTAH, INC., ET AL., DEBTOR

(Case No. 90B-6721)
(Case No. 90B-6722)
(Case No. 90B-6723)
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(Case No. 90B-6730)

(CF&I FABRICATORS OF UTAH, INC.) (COLORADO & UTAH LAND CO.) (KANSAS METALS COMPANY) (ALBUQUERQUE METALS COMPANY) (PUEBLO METALS COMPANY) (DENVER METALS COMPANY) (PUEBLO RAILROAD SERVICE CO.) (CF&I FABRICATORS OF COLORADO, INC.) (CF&I STEEL CORPORATION) (THE COLORADO AND WYOMING RAILWAY COMPANY)

MEMORANDUM DECISION AND ORDER RELATING TO DEBTORS' OBJECTIONS, DATED 10/02/92, FOR DISALLOWANCE AND DETERMINATION OF PRIORITY OF CLAIMS OF THE INTERNAL REVENUE SERVICE

On November 7, 1990, these related steel production companies (Debtors) filed petitions under chapter 11, primarily in an attempt to reorganize in light of their inability to fund two defined benefit pension plans. The United States of America, Department of the Treasury, Internal Revenue Service (IRS), filed proofs of claim [1] against each of the Debtors jointly and severally asserting priority tax claims under § 507(a)(7)(E) and (G) of the United States Bankruptcy Code or alternatively as administrative claims for "excise taxes" pursuant to 26 U.S.C. § 4971(a) and (b) (section 4971). The claims are based on the Debtors' failure to pay certain amounts due under their pension plans. Both the Debtors and the Official Unsecured Creditors Committee (Committee)[2] objected to the proofs of claim. The legal issues were presented to the court in a claims objection hearing on November 13, 1992.[3] Speedy resolution of the

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[1] The IRS filed an identical claim in each Debtor's case that will be referred to collectively as the proofs of claim.

[2] The Committee has fully participated in arguing the issues in dispute here, and its argument generally tracks and supports the position of the Debtors. Where reference is made to the position of the Debtors, the court acknowledges that the Committee's position is similar.

[3] The Debtors have also filed an adversary proceeding involving much the same arguments presented here, but including a prayer for equitable subordination under 11 U.S.C. § 506(c) as additional relief.

legal issues is critical. The Debtors' hopes for reorganization center upon the sale of portions of the Debtors' assets implemented through a proposed plan of reorganization. The prospective purchaser has established a schedule that requires resolution of these and other issues or its participation in the Debtors' reorganization will be withdrawn. If the court allows the status asserted by the IRS for its claims, it is unlikely that the Debtors will have sufficient funding to propose a feasible plan of reorganization. Because of the critical nature of the resolution of these core issues, the court issued a bench ruling at the hearing, but indicated that it would supplement the bench ruling with a written decision.

FACTS

At the time of filing, the Debtors were sponsors of two pension plans that provided pension and pension-related benefits for employees and retirees. CF&I Steel Corporation (CF&I) was the administrator of those plans. These two pension plans were the Pension Plan of CF&I Steel Corporation and Certain Subsidiaries (the Master Plan)and the Non-Contributory Pension Plan of CF&I Steel Corporation as Amended and Restated Effective January 1, 1989, (the Non-Contributory Plan). Under these pension plans, CF&I promised to provide fixed pension benefits calculated with reference to each employee's pay and years of service. CF&I was obligated to provide annual funding contributions based on the actuarial valuation of the benefits earned by its employees.

The Pension Benefit Guaranty Corporation (PBGC) is a wholly-owned United States government corporation established under § 4002 of the Employee Re-

tirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1302, to administer the pension plan termination provision of Title IV of ERISA, 29 U.S.C. §§ 1302-1461. The PBGC is required to guarantee payment of non-forfeitable or vested benefits under terminated pension plans, subject to certain limitations. If the PBGC pays pension benefits pursuant to its guaranty under the terminated pension plans, the funds do not come from the United States treasury, but from insurance premiums paid by sponsors of ERISA qualified plans.

CF&I failed to make the minimum funding payment of $12,400,000 on the Master Plan for the year ending December 31, 1989. The payment should have accompanied CF&I's form 5330 annual report that the parties agree was due on September 15, 1990. On November 7, 1990, the Debtors filed petitions for reorganization under chapter 11 of the Bankruptcy Code. Since the date of filing, the Debtors have not made any continuing minimum funding payments to the pension plans attributable to services rendered by employees before the date of filing. The annual reports and minimum funding payments for the year ending December 31, 1990, of approximately $12,-100,000, were due September 15, 1991. The Debtors assert the pension plans are pre-petition obligations, therefore, the Debtors did not make the minimum funding payments for 1990.[4]

[4] On March 13, 1991, the PBGC filed two proofs of claim against each of the Debtors in connection with the Master Plan. These claims fall into two general categories: (1) claims for unfunded benefit liabilities under the Master Plan (the Unfunded Benefit Claims) designed to reimburse the PBGC for at least a portion of the amounts that it must pay

The Debtors attempted to persuade the PBGC into terminating the Master Plan both before and after filing the chapter 11 petitions. It was not until March 19, 1992, that the PBGC instituted proceedings to terminate the Master Plan. The Non-Contributory Pension Plan has not been terminated. CF&I, on behalf of the Master Plan, consented to the termination and entered into a trusteeship agreement with the PBGC effective March 19, 1992, and the PBGC became the successor trustee of the Master Plan. The PBGC became liable for guaranteed benefits to plan participants.

IRS CLAIMS

Under section 4971(a), the IRS imposes an immediate 10% "first tier" tax based on the accumulated funding deficiency if the employer fails to make the minimum funding contribution by the date when the employer's annual report is due (in this case reports for both plan were due on September 15, 1990). If the sponsoring employer does not thereafter correct the accumulated funding deficiency by making the required contribution to the applicable pension

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to pensioners from its own funds; and (2) claims for due and unpaid minimum funding contributions allegedly due and owing the Master Plan (the Minimum Contribution Claims). On July 1, 1992, after termination of the Master Plan, the PBGC amended its proofs of claims, increasing the amount of each of the ten Unfunded Benefit Claims to an estimated amount of $263,200,000 and the amount of each of the ten Minimum Contribution Claims to an estimated amount of $64,874,511. The claims were filed variously as priority or administrative claims. The court has ruled that the majority of the PBGC's claims are pre-petition, unsecured claims, not entitled to priority or administrative payment status.

plan during the taxable period as defined in section 4971(c)(3), then section 4971(b) imposes an additional "second tier" tax on the employer equal to 100% of the amount of the accumulated funding deficiency.

On March 13, 1991, the IRS timely filed various proofs of claim asserting tax liability based on excise taxes pursuant to section 4971. The proofs of claim alternatively asserted secured or priority status for section 4971(a) liability for the 1989 plan year assessed January 21, 1991. They also included a claim indicating "examination liability unassessed" for the second tier excise tax for the 1989 plan year. The IRS audited the second tier tax for the plan year 1989, and issued a post-petition notice of deficiency to the Debtors for the 1989 second tier liability. The original proofs of claim made no reference to section 4971 liability for 1990, despite an assertion in the IRS memorandum to the contrary. The IRS audited the 1990 plan year and issued the appropriate notice letters to the Debtors on September 3, 1992. The proofs of claim indicate that the 1989 second tier and the 1990 first and second tier excise taxes remain unassessed.

The original proofs of claim filed by the IRS also included amounts for income taxes for 1983 and income taxes under audit for 1984 and 1985. The only amount indicated on the original proofs of claim regarding income tax liability for 1987, 1988, and 1989, was an amount owing of $.00 with an asterisk referring to an explanation in which the IRS asserted a "protective" claim.[5]

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[5] The original proofs of claim contained the following language: "No income tax liability is shown for the tax years

The IRS amended each of its proofs of claim on September 24, 1992, three weeks prior to the filing of the Debtors' disclosure statement, and after the claims bar date. The amended proofs of claim declare that the 1989 tax claimed pursuant to section 4971(a) is a pre-petition priority tax liability and asserts that the Debtors must pay, in addition to the claims of the PBGC for the underlying funding payment of $12,400,000, the following amounts:[6]

Plan Number[7]	1989 10% First Tier section 4971(a)
010	$ 1,205,047.00
008	$ 36,577.00

The amended proofs of claims state that the 1989 section 4971(b) and the 1990 section 4971(a) and (b) claims are post-petition tax liabilities entitled to administrative expense priority pursuant to 11 U.S.C. § 503(b)(1)(B)(i) in the following amounts:

85 through 89 for the consolidated group of corporations of which CF&I Steel Corporation was the parent corporation. The returns for those years report net operating losses for all years except 1987. The carryback and/or carryforward of losses from other years to 1987 eliminates the income tax liability shown for 1987. These returns have not yet been audited but could be audited in the future for the purpose of eliminating any net operating loss carryforward which the debtor might attempt to claim."

[6] The IRS has asserted general unsecured claims for late payment penalties and interest of $198,713 for failure to pay the 1989 10% first tier penalties under section 4971(a).

[7] The IRS has designated the Master Plan as plan 010, and the Non-Contributory Plan as plan 008 in its proofs of claim.

Plan Number	1990 10% first tier section 4971(a)
010	$ 2,508,154.70
008	$ 54,258.80

Plan number	1989 100% second tier section 4971(b)
010	$12,050,472.00
008	$ 308,966.00

Plan number	1990 100% second tier section 4917(b)
010	$25,081,547.00
008	$ 542,588.10

Alternatively, if the court does not accord the claims post-petition administrative status, the IRS asserts the claims represent pre-petition priority taxes under 11 U.S.C. § 507(a)(7)(E) and (G). The amended IRS proofs of claim also seek income taxes and interest to the date of the petition of $265,910.62 due for the years 1987, 1988, and 1988 pursuant to an audit completed after the IRS filed the original proofs of claim.

On December 2, 1992, the Debtors filed objections to the IRS proofs of claim. The Debtors object to all the section 4971 excise tax claims asserted pursuant to 11 U.S.C. § 507(a)(7)(E) and argue that the claims are, in fact, penalties and must be disallowed. They also contend that the section 4971 excise tax claims are not pecuniary loss penalties related to a governmental claim under 11 U.S.C. § 507(a)(7)(G) and should be disallowed.[8] In addition, the Debtors objected to the 1989 section 4971(b) second tier claims and the 1990 section 4971(a) and (b) claims.

[8] The Debtors object to the classification of the 1989 first tier claims as administrative claims under 11 U.S.C. § 503, but is not apparent from the amended proofs of claim that the IRS asserted administrative status for these claims.

They maintain that as of the date of filing, the taxable period had not expired and that they are still able to avoid the 100% penalty by correcting the accumulated funding deficiency for 1989, but that they are prohibited from so doing except pursuant to a plan of reorganization or as directed by this Court. The Debtors expect the IRS to assert section 4971(a) and (b) claims against the Debtors for each year, *ad infinitum*, in which the Debtors are prohibited from making the minimum funding payments by virtue of the filing of these chapter 11 proceedings. The Debtors also argue that any priority claims filed by the IRS for section 4971(a) and (b) claims for 1990 are late filed and should be disallowed.

The Debtors also object to those portions of the amended claims that add prepetition priority income tax liability for 1987, 1988, and 1989 as untimely filed. The IRS contends the 1987, 1988, and 1989 income tax liabilities were included in the initial timely filed claims by incorporating the protective language contained in the proofs of claim and that the claims filed after the bar date were merely amendments to cure defects in the previously filed claims.

ISSUES

A. The proofs of claim represent exactions that are not excise taxes allowed priority payment pursuant to 11 U.S.C. § 507(a)(7)(E), and are not pecuniary loss penalties allowed priority payment pursuant to 11 U.S.C. § 507(a)(7)(G).

The initial issue presented in resolving the Debtors' objections to the IRS's proofs of claim is to determine if the IRS's characterization of the claims as

excise taxes is correct. The IRS describes its claims as excise taxes based, not unreasonably, on the caption of section 4971 that indicates "Subtitle D-Miscellaneous Excise Taxes." All parties, however, acknowledge that the legislative history indicates that the excise taxes created in section 4971 are, in reality, penalties imposed upon an employer to prevent an accumulated funding deficiency under a plan.[9] No argument has been advanced that these claims in fact compensate the United States for actual pecuniary loss. Payment by the PBGC of any nonforfeitable or vested benefits under terminated pension plans is from premiums collected from all ERISA qualified plan sponsors, and not by the United States from general revenue. Though the IRS acknowledges that legislative intent indicates the taxes imposed are penalties, it asserts this court may not look at the actual nature of the exaction, but must rely on the designation stated by Congress in the statute and may not re-characterize the IRS's classification of the excise taxes.

The IRS relies on the Sixth Circuit's reversal of the lower courts in *In re Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (6th Cir. 1991) *cert. denied sub nom, Krugliak v. United States*, 112 S.Ct. 1165 (1992), as being directly on point and controlling in

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[9] The legislative history indicates: "The bill also provides new and more effective *penalties* where employers fail to meet the funding standards . . . This procedure, however, has proved to be defective since it does not directly *penalize* those responsible for the under-funding. For this reason, the bill places the obligation for funding and the *penalty* for under-funding on the person on whom it belongs—namely, the employer." H.R. Rep. No. 807, 93rd Cong., 2nd Sess. 28 (1974), reprinted in 1974 U.S.C.C.A.N. 4670, 4694-95 (italics added).

this case. *Mansfield* held that, since section 4971 was an existing federal excise tax at the time the Bankruptcy Code was enacted, Congress meant to include those exactions in the category Congress itself had previously deemed to be federal excise taxes under 11 U.S.C. § 507(a)(7)(E). *Mansfield* held that courts should not employ any other test to determine if the section 4971 taxes are in fact excise taxes. *Mansfield* indicated that such deference would not be given, however, in cases involving state and local exactions. In those instances, a federal question arises, therefore a federal court may determine whether the state or local tax characterization is correct when applied to the Bankruptcy Code.

The Debtors invite this court to conclude that *Mansfield* is unnecessarily rigid and contrary to prior law. Instead, they argue that this court is empowered to look behind Congress' characterization of the tax and should instead employ a four part test to determine if the assessment is properly characterized as a tax.[10] The IRS agreed that if the court employed

[10] In *County Sanitation Dist. No. 2 of Los Angeles County v. Lorber Industries of California, Inc. (In re Lorber Indus. of California, Inc.)* 675 F.2d 1062, 1066 (9th Cir. 1982), citing *Dugan v. Dept. of Agriculture, State of Cal.*, 332 F.2d 793 (9th Cir. 1964), the Ninth Circuit approved the following four part test to determine the elements of whether a state charge can be afforded tax priority under the Bankruptcy Act:

1) An involuntary pecuniary burden, regardless of name, laid upon individuals or property;

2) Imposed by, or under authority of the legislature;

3) For public purposes, including the purpose of defraying expenses of government or undertakings authorized by it;

4) Under the police or taxing power of the state.

such a test it would not be able to sustain the position that the section 4971 excise taxes are not penalties because it could not meet the third prong of the *Lorber Industries* test. *In re Cassidy*, 126 B.R. 94, 96-8 (Bankr. D. Colo. 1991); *In re Airlift Int'l., Inc.*, 120 B.R. 597, 601 (S.D. Fla. 1990).

This issue should be viewed in the context of the Tenth Circuit's controlling instruction that courts should not interpret a statute so that the literal meaning of the words thwarts the obvious purpose of a statute. *State of Okla. ex. rel., Dept. of Human Serv. v. Weinberger*, 741 F.2d 290, 292 (10th Cir. 1983). Even in *Mansfield*, the court acknowledged that there are "rare cases" in which the literal application of a statute will produce a result at odds with the intent of the statute. *Mansfield*, 942 F.2d at 1059, citing *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982). Courts should also be circumspect in interpreting ERISA, or related provisions of the Internal Revenue Code, in a manner that alters or impairs the Bankruptcy Code.[11]

This court concludes that the label adopted by Congress in its characterization of these excise taxes is not controlling, especially where blind acceptance of the label would defeat the purpose of the Bankruptcy Code. *United States v. Unsecured Creditors Comm. of C-T of Va., Inc. (In re C-T of Va.)*, 1992 WL 247459 (4th Cir., Oct. 2, 1992) (it is the purpose of

[11] ERISA § 514(d), 29 U.S.C. § 1144(d), indicates that in interpreting ERISA, "nothing in this title shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 1031 and 1137(c) of this title) or any rule or regulation issued under any such law."

the tax, not its name, that controls); *United States v. River Coal Co., Inc.*, 748 F.2d 1103, 1106 (6th Cir. 1984) (fact that Congress labeled a reclamation charge a fee rather than a tax is not controlling); *In re Unified Control Sys., Inc., v. I.R.S. (In re Unified Control Sys., Inc.)*, 586 F.2d 1036, 1037-38 (5th Cir. 1978) (label placed upon an imposition in a revenue measure is not decisive in determining its character); *United Steelworkers of America, AFL-CIO-CLC v. PBGC (In re Wheeling-Pittsburgh Steel Corp.)*, 103 B.R. 672, 693 (W. D. Penn., 1989) (the mere label of an exaction as a tax will not govern its characterization for purposes of bankruptcy law); *Kline v. Feinblatt*, 403 F. Supp. 974, 977 (D. Md. 1975) *aff'd.* 547 F.2d 823 (4th Cir. 1977) (finding §§ 4941 and 4944 of the IRS Code to be penalties, court indicated the name given to the exaction by the legislature is not conclusive).[12]

This case presents one of those "rare cases" where the court should examine the characterization of the statute because of the obvious inconsistencies that arise if the excise tax status is upheld. First, unlike *Mansfield*, the IRS's section 4971 claims are for both the first and the second tier taxes. This court previously found that the claims of the PBGC for the underlying obligation are, for the most part, pre-petition unsecured claims. To allow priority treatment for alleged tax claims based on pension funding deficiencies, when the pension plan's claims do not receive such treatment, would elevate the section 4971 claims to a status ahead of those claims. Second, such an interpretation would result in state and local taxes being subject to judicial scrutiny, but not federal taxes. The effect could be that state taxes would be treated differently or accorded different priority than federal taxes and the Bankruptcy Code does not contemplate such disparate treatment. Third, the payment of such large priority claims would defeat any attempt by the Debtors to reorganize, would prevent any return to creditors and would provide a windfall to the IRS. Fourth, such an interpretation would harm the parties that are intended to be protected by the pension plan that section 4971 seeks to enforce, because payment of section 4971 penalty claims would be at the expense of pre-petition unsecured creditors including pensioners. Fifth, allowance of the 1990 first and second tier claims and the 1989 second tier claims would penalize the Detbors for obeying the Bankruptcy Code. The Debtors complied with the Bankruptcy Code by not paying pre-petition debts outside a plan of reorganization. However, it is the Debtors compliance with the Bankruptcy Code that results in the accrual of the section 4971 claims after the date of filing.[13] Based upon the fore-

[12] *Mansfield* considered but rejected *Unified Control Systems, River Coal Co.* and *Kline*, considering them as wrongly decided because they blurred the distinction between a federal question involving a state statute and a characterization made by Congress. Each case, however, found additional equitable reasons for looking behind the label applied to a tax when considered in light of the purpose of the applicable statute.

[13] In *In re Wheeling-Pittsburgh Steel Corp.*, 103 B.R. 672, 694 (W.D. Pa. 1989), the court found that the IRS's claims under section 4971 were penalty claims for bankruptcy purposes. Since Wheeling-Pittsburgh was forbidden from paying pre-petition plan contributions post-petition under the bankruptcy law, equitable considerations dictated that the IRS's claims be disallowed so as not to punish the debtor's credtiors.

going, the court finds that it is empowered, under the circumstances of this case, to look behind the characterization of the exaction set forth in the statute and focus on the actual nature of the claims. Based on its own independent application of the four pronged test advanced in *Lorber Industries*, the court finds the IRS has failed to meet the third prong of the test. The excise taxes are penalty claims, and that the penalty claims are not assessed as compensation for the government's actual pecuniary loss. Therefore, to the extent that the IRS's section 4971 claims for 1989 and 1990 are deemed to be pre-petition claims, they are not afforded priority status under § 507 (a)(7)(E) or (G).

B. The section 4971 penalty claims are not entitled to administrative status under 11 U.S.C. § 503.

The Debtors object to the IRS's proofs of claim that assert post-petition administrative status for the penalty claims. The IRS argues that its 1989 and 1990 section 4971(b) claims all accrued post-petition because either the notice of deficiency was mailed or the date of assessment occurred post-petition creating administrative expenses.[14] Likewise the 1990 section 4971(a) liability arose as a result of the post-petition failure of the Debtors to pay the accumulated funding deficiency on September 15, 1991. The IRS's statement of the date these events transpired is correct, but the IRS's position ignores the effects the filing of the Debtors' chapter 11 petitions had on the underlying obligation.

The IRS declares that a tax is incurred by the estate on the date that the tax accrues. *See, e.g., In re O.P.M. Leasing Servs., Inc.*, 68 B.R. 979 (Bankr. S.D.N.Y. 1987); *accord Wheeling-Pittsburgh Steel Corp.*, 103 B.R. at 693. Because the IRS sent notice of deficiency for the 1989 and 1990 section 4971(b) claims post-petition, and because the IRS assessed the penalties post-petition,[15] the IRS argues the penalties were incurred as administrative expenses.

The difficulty with the IRS's approach is that it presumes that it assessed excise taxes instead of penalties, and that an obligation has been incurred by the Debtors post-petition in spite of the operation of the automatic stay. The Bankruptcy Code prevented payment of the pre-petition obligation that is the foundation of the IRS penalty claims. The operation of the

[14] The IRS argues that the section 4971(a) excise tax accrues as of the date eight and one-half months after the end of the plan year, or for 1989, on September 15, 1990. *See*. Temp. Treas. Reg. § 11,412(c)-12(b). The IRS also takes the position that the section 4971(b) claims accrue as of the earlier of the date of mailing of a notice of deficiency with respect to the penalty imposed by section 4971(a) or the date of assessment of the tax if the funding deficiency has not been cured. Section 4971(a)(3)(A) and (B). In this case, both the notice of deficiency and the date of assessment, if any, for the 1989 section 4971(b) and the 1990 section 4971(a) and (b) occurred post-petition.

[15] IRS relies upon the District Court Rule of Bankruptcy Practice and Procedure, D. Utah 508, that indicates that the stay afforded by 11 U.S.C. § 362 is modified to allow the IRS to assess tax liabilities unless a party in interest objects and the court orders otherwise. This provision is of no comfort to the IRS because it allows for the assessment of taxes, not for the assessment of penalties such as the section 4971 claims asserted in this case.

automatic stay tolled the correction period so that the claims have not yet been incurred and remain contingent claims. Therefore, there are no taxes to which the penalties attach.

The bankruptcy filing prohibited the Debtors from making any payment on the underlying pre-petition obligation that is the basis for the penalty claims, except payment through a plan of reorganization or as ordered by the court. *Official Comm. of Equity Security Holders v. Mabey (In Re A.H. Robins Co.)*, 832 F.2d 299, 302 (4th Cir. 1987), *cert. denied*, 485 U.S. 962 (1988). Since the basis for the IRS's proofs of claim for these periods is the Debtors' compliance with the Bankruptcy Code, it would be inequitable to allow the claims. Any failure to make such contribution is protected under bankruptcy law and cannot be penalized by the IRS. *Wheeling-Pittsburgh Steel Corp.*, 103 B.R. at 693.

The penalty claims are also contingent because section 4971(b) provides that the claims do not arise unless the accumulated deficiency is not *corrected* within the taxable period. The correction period does not expire until at least ninety days after the date on which the IRS mails notice of deficiency for the 10% first tier penalty due under section 4971(a). Under section 4961(a), the correction period is extended for ninety days following the mailing of the notice of deficiency, and for any additional time beyond the ninety days during which "a deficiency cannot be assessed under section 6213(a)" of the Internal Revenue Code. 26 U.S.C. §§ 4961(a), 4963(e)(1). One such period is the period during which a debtor is prevented from filing a petition in the United States Tax Court, and for sixty days thereafter. Since 11

U.S.C. § 362(a)(8) precludes the commencement or continuation of a proceeding before the United States Tax Court, the correction period extends until sixty days after the conclusion of the bankruptcy proceeding. Therefore, the running of the correction period is tolled during the period in which the automatic stay is in effect and no 100% penalty may be assessed. *Wheeling-Pittsburgh Steel Corp.*, 103 B.R. at 695.

The 1989 plan year correction period was still open as of the date of filing of these petitions and remains open. The notice of deficiency for 1990 was issued while the automatic stay was in effect, therefore, the correction period cannot expire until 150 days after the date on which the stay expires. The Debtors argue that the term "correct" means to contribute to the pension plan the amount necessary to reduce the accumulated funding deficiency, as of the end of the plan year, to zero. The confirmation of a plan operates to discharge "all claims and interest of creditors," thus effectively reducing all claims to zero. 11 U.S.C. § 1141. The Debtors propose that the pre-petition claims related to the pension plans can be cured or corrected through their proposed plan. This may be correct, but the proposed plan has not been confirmed and the court makes no determination at this time that such a provision would cure or correct the funding deficiency. The court reserves any ruling based upon this theory until the facts of the case support consideration of the argument.

The language of 11 U.S.C. § 503(b)(1)(C) grants administrative status to "any fine, penalty or reduction in credit *relating to a tax of a kind specified in subparagraph (B) of this paragraph*." 11 U.S.C. § 503(b)(1)(C) emphasis added). The logical in-

terpretation of this language is that such penalty must relate to a tax allowed administrative status under 11 U.S.C. § 503(b). Though it may be argued that 11 U.S.C. § 503(b)(1)(C) includes penalties without the restriction that such penalties be compensation for actual pecuniary losses and may therefore include section 4971 penalties, these penalties do not relate to a tax. The Debtors are subject to section 4971 liability on the accumulated funding deficiency in the qualified plan resulting from failure to make minimum contributions to the plan rather than failure to pay any identifiable, separate, revenue producing tax. The only obligation related to the section 4971 penalty is the obligation owed by the Debtors to fund the pension plan, or upon termination of the plan, the obligation to pay any under-funding to the PBGC. The Debtors simply have no underlying obligation owing to the United States that can be characterized as a tax.

Based upon a consideration of all the foregoing factors, the court finds that the IRS's proofs of claim for 1989 section 4971(b) and for 1990 section 4971(a) and (b) are disallowed and expunged. *See, e.g., LTV Corp. v. IRS, (In re Chateaugay Corp.)*, slip op. Nos. 92 Civ. 3394, 3395 (S.D.N.Y. October 19, 1992). If the Debtors fail to confirm a plan that cures the accumulated funding deficiency, the IRS may be entitled to file an administrative claim and again assert administrative status for a portion of its proofs of claim. But for a determination whether such claims may be allowed must await circumstances different from those currently before the court.

C. The timeliness of the IRS proofs of claim raises issues of fact that must be resolved through an evidentiary hearing.

The third basis for the Debtors' objections to the proofs of claim is that a portion of the claims are untimely. The Debtors contend that the IRS should not be permitted to amend its proofs of claim to assert additional income tax liabilities for 1987, 1988 and 1989, or to assert new pre-petition section 4971 liabilities for 1990. The IRS argues that the protective language in the original proofs of claim clearly placed the 1985 through 1989 income tax liabilities in issue. The IRS reasons that the original proofs of claim may not have indicated the exact nature of the tax liability, but the Debtors were on notice that an income tax audit could be anticipated for those years. The IRS admits that there was no specific language in the original proofs of claim regarding the 1990 liability under section 4971 because the IRS viewed this liability as post-petition administrative liability. However, the IRS argues that its original proofs of claim did inform the Debtors of the general concept of placing these liabilities at issue. Nonetheless, the IRS claimed the 1990 excise taxes as priority pre-petition taxes as well as post-petition administrative taxes.

Although amendments to proofs of claim may be freely permitted "to cure a defect in the claim as originally filed," a creditor may not assert new claims after the bar date under the guise of amending its claim. *In re Unioil, Inc.*, 962 F.2d 988, 992 (10th Cir. 1992) (quoting *LeaseAmerica Corp. v. Eckel*, 710 F.2d 1470, 1473 (10th Cir. 1983)). In *Unioil*, an individual creditor sought by motion to amend his

proof of claim to identify a trust as the proper principal on whose behalf he was pursuing the claim. The court held that ordinarily an amendment of a proof of claim is freely permitted so long as the claim initially provided adequate notice of the existence, nature, and amount of the claim as well as the creditor's intent to hold the estate liable, but a truly new claim should not be permitted. The court found that the original proof of claim at issue in that case was adequate and that its content was unaltered by the requested amendment. The court concluded that under the particular circumstances before it, the debtor was not prejudiced by the amendment because the amended proof of claim asserted the same substantive interests as the original proof of claim. *Unioil*, 962 F.2d at 993.

The IRS suggests that in *Unioil*, the Tenth Circuit took a more liberal approach to claims amendment than the traditional view. This court finds nothing in the *Unioil* decision that deviates from the traditional narrow standard that an amendment is permitted only where the creditor provided notice to the debtor of the existence, nature and amount of the claim and the creditor's intent to hold the estate liable. *Walsh v. Lockhart Assocs.*, 339 F.2d 417 (5th Cir.), *cert. denied*, 380 U.S. 953 (1965).

The IRS' original proofs of claim listed income tax liability for 1985-89 as $.00. The IRS reserved the right to audit the Debtors' returns for tax years 1985 through 1989 for the "purpose of eliminating any net operating loss carryforward which the debtor might attempt to claim." The IRS may have intended the Debtors to infer from this protective language notice that some amount of additional income tax liability

may arise from the audit as a result of a change in calculating the loss carryforward which the Debtors were entitled to claim. The IRS admits that liability for "alternative minimum tax was not identified in the proof of claim but was clearly a possibility from the audit." IRS Response at p. 24. It does not appear from this anticipatory language that the IRS could maintain a claim for additional income tax liability if the audit produced evidence and the amended proofs of claim were based, for example, on the Debtors under-reported income or resulted from improper claims of other types of deductions.

Even if it were reasonable to make such an inference regarding the existence and nature of the additional tax liability resulting from elimination of a loss carryforward, the amount of the additional tax liability could not be even remotely inferred from the original claim. It is unlikely that, on its face, an inference of increased tax liability without any indication of the amount of increase supplies sufficient notice to the Debtors to open the door for a later amendment intended merely to cure a defect. In this case, whether: (1) the original proofs of claim were sufficient to provide notice of the nature of the IRS's claim; (2) the Debtors made the correct inference from the original proofs of claim and; (3) the additional income tax liability actually resulted from adjustment to the amount of loss carryforward available to the Debtors is a factual determination that the court reserves for a later evidentiary proceeding.

D. The 1990 priority tax proofs of claim are untimely filed.

The IRS admits that the amendment to add the section 4971 liability for the Debtors' 1990 pension

plan funding deficiency is problematic. It is clear from the original proofs of claim that the IRS attempted to protect its claim for section 4971 liability for the plan year ending December 31, 1989. The IRS reasons that the protective language regarding the 1989 excise tax put the Debtors on notice of the general concept of continuing liability for subsequent years. The IRS also relies on its characterization of section 4971 penalties as an administrative expense liability for its failure to anticipate and include the 1990 section 4971 liability on the original proofs of claim. The IRS claims priority status for the 1990 section 4971 claims as well as administrative expense status.

As the IRS noted, many courts summarily disallow amended claims to add additional tax periods for the same type of tax. *See, e.g., In re Butcher*, 74 B.R. 211 (Bankr. E.D. Tenn. 1987). Other courts allow addition of another tax period of the same type of liability as an almost automatic amendment. *See, e.g., In re Bajac Const. Co.*, 100 B.R. 524 (Bankr. E.D. Cal. 1989). Even under the most generous standard of freely allowing amendments used by other courts outside the Tenth Circuit, if the 1990 liability was determined to be a pre-petition obligation, the amendment to add new and unspecified liability for the 1990 section 4971 penalties could not be allowed. In the present case, the reorganization is too far along and the various parties that have struggled over formulation of a plan would be adversely prejudiced if the court permitted such an amendment. Furthermore, applying the two-step analysis of *Unioil* leads to the same result. Even if it could be argued that the Debtors had notice of the existence and amount

of the 1990 excise liability, such an amendment does much more than merely cure a defect, it creates a new claim. This new claim would insolubly delay and complicate the administration of this estate. Permitting a late-filed amendment for an additional tax period that triples the amount of the original claim this close to plan confirmation cannot be justified under these circumstances. The court will not exercise its discretion to allow such an amendment.

CONCLUSION

In accord with the above determination, the section 4971 assessments against the Debtors are in fact penalties that do not compensate the United States for actual pecuniary loss. The penalties asserted by the IRS as administrative claims are disallowed and expunged because the proofs of claim penalize the creditors of these Debtors for the Debtors' compliance with the Bankruptcy Code's prohibition against satisfaction of pre-petition claims absent a confirmed plan of reorganization, because of their contingent nature, and because the Debtors' right to cure any deficiency has not expired. The court will not as a matter of law disallow the pre-petition income tax claims, but will reserve ruling thereon pending an evidentiary hearing.

Based upon the forgoing, it is hereby

ORDERED, as follows:

1) the 26 U.S.C. § 4971(a) and (b) proofs of claim for excise taxes are in fact penalty claims and are therefore denied priority status under § 507(a)(7)(E);

2) the 26 U.S.C. § 4971 (a) and (b) proofs of claim are not in compensation for actual pecuniary loss and are therefore denied priority status under § 507(a)(7)(G);

3) the 1989 26 U.S.C. § 4971(b) and the 1990 26 U.S.C. § 4971(a) and (b) proofs of claim are not entitled to administrative status and are expunged;

4) the 1989 26 U.S.C. § 4971(a) proofs of claim are pre-petition unsecured claims;

5) no determination is made at this time as to whether any pre-petition unsecured claim asserted by the IRS is subject to equitable subordination;

6) to the extent that the 1990 penalty claims may have accrued pre-petition, they are disallowed because such claims were not timely filed;

7) the court reserves ruling as to whether the 1987, 1988, and 1989 income tax liability contained in the amended proofs of claim were timely filed pending an evidentiary hearing; and

8) future proofs of claim filed by the IRS pursuant to 26 U.S.C. § 4971 that may arise because of the Debtors' failure to cure or correct the prepetition accumulated funding deficiency are not entitled to preferred status until such time as this court determines that no cure or correction of the deficiency has been effectuated.

DATED this 25 day of November, 1992.

/s/ Judith A. Boulden
JUDITH A. BOULDEN
United States Bankruptcy Judge

APPENDIX F

1. Section 507, 11 U.S.C. (1988), provides in relevant part:

(a) The following expenses and claims have priority in the following order:

* * * * *

(7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—

* * * * *

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

* * * * *

2. Section 510, 11 U.S.C., provides in relevant part:

* * * * *

(c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may—

(1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an al-

lowed interest to all or part of another allowed interest; or

(2) order that any lien securing such a subordinated claim be transferred to the estate.

3. Section 4971, 26 U.S.C. (1988), provides in relevant part:

(a) Initial tax

For each taxable year of an employer who maintains a plan to which section 412 applies, there is hereby imposed a tax of 10 percent (5 percent in the case of a multiemployer plan) on the amount of the accumulated funding deficiency under the plan, determined as of the end of the plan year ending with or within such taxable year.

(b) Additional tax

In any case in which an initial tax is imposed by subsection (a) on an accumulated funding deficiency and such accumulated funding deficiency is not corrected within the taxable period. there is hereby imposed a tax equal to 100 percent of such accumulated funding deficiency to the extent not corrected.

(c) Definitions

For purposes of this section—

(1) Accumulated funding deficiency

The term "accumulated funding deficiency" has the meaning given to such term by the last two sentences of section 412 (a).

(2) Correct

The term "correct" means, with respect to an accumulated funding deficiency, the contribution, to or under the plan, of the amount necessary to reduce such accumulated funding deficiency as of the end of a plan year in which such deficiency arose to zero.

(3) Taxable period

The term "taxable period" means, with respect to an accumulated funding deficiency, the period beginning with the end of the plan year in which there is an accumulated funding deficiency and ending on the earlier of—

(A) the date of mailing of a notice of deficiency with respect to the tax imposed by subsection (a), or

(B) the date on which the tax imposed by subsection (a) is assessed.

(d) Notification of the Secretary of Labor

Before issuing a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary shall notify the Secretary of Labor and provide him a reasonable opportunity (but not more than 60 days)—

(1) to require the employer responsible for contributing to or under the plan to eliminate the accumulated funding deficiency, or

(2) to comment on the imposition of such tax.

In the case of a multiemployer plan which is in reorganization under section 418, the same notice and opportunity shall be provided to the Pension Benefit Guaranty Corporation.

(e) Liability for tax

(1) In general

Except as provided in paragraph (2), the tax imposed by subsection (a) or (b) shall be paid by the employer responsible for contributing to or under the plan the amount described in section 412(b)(3)(A).

(2) Joint and several liability where employer member of controlled group

(A) In general

In the case of a plan other than a multiemployer plan, if the employer referred to in paragraph (1) is a member of a controlled group, each member of such group shall be jointly and severally liable for the tax imposed by subsection (a) or (b).

(B) Controlled group

For purposes of subparagraph (A), the term "controlled group" means any group treated as a single employer under subsection (b), (c), (m) or (*o*) of section 414.

* * * * *

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No. 95-325

In The

Supreme Court of the United States

October Term, 1995

UNITED STATES OF AMERICA,

Petitioner,

vs.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Bankruptcy Code's priority for "an excise tax on a transaction occurring[,]" (11 U.S.C. § 507(a)(7)(E)(i)),[1] extends to a claim under 26 U.S.C. § 4971(a), labeled as a "tax" but imposed as a penalty for the non-occurence of required pension plan contributions and not in compensation for any actual pecuniary loss to the Internal Revenue Service?

2. Whether such a claim, under the unique facts and circumstances of these liquidating Chapter 11 cases and the plan of reorganization, may be given a lower distributive priority than the claims of general unsecured creditors who suffered actual pecuniary losses, under (a) 11 U.S.C. § 510(c), or (b) 11 U.S.C. §§ 1122(a), 1123(a)(1), 1123(a)(4), 1129(a)(7), 1129(b)(1), and 502(j)?

---

1. Under the Bankruptcy Reform Act of 1994, the priority for certain excise tax claims has been moved from Section 507(a)(7)(E) to Section 507(a)(8)(E) of the Bankruptcy Code. Pub. L. No. 103-394, § 304(c), 108 Stat. 4106, 4132 (Oct. 22, 1994). That amendment does not affect this case and, for consistency, this brief cites the excise tax priority as 11 U.S.C. § 507(a)(7)(E).

RULE 29.1 STATEMENT

On November 7, 1990, the date of the petition for relief under Chapter 11 in Respondents' bankruptcy cases, CF&I Steel Corporation was a publicly owned corporation and was the sole owner of the stock of nine subsidiaries: CF&I Fabricators of Utah, Inc., Colorado & Utah Land Company, Kansas Metals Company, Albuquerque Metals Company, Pueblo Metals Company, Denver Metals Company, Pueblo Railroad Service Company, CF&I Fabricators of Colorado, Inc., and Colorado and Wyoming Railway Company.

On March 3, 1993, the effective date of the liquidating Chapter 11 plan confirmed by the bankruptcy court, all interests of stockholders were canceled, including the interests of CF&I Steel Corporation as sole stockholder of each of the other corporate debtors (Pet. 24a). Accordingly, Respondents are no longer "a corporation and nine wholly-owned subsidiaries" as the petition for a writ of certiorari states (Pet. 2). Respondents are ten separate corporate shells without stockholders, officers, or directors and are governed by Scott C. King, a representative of creditors appointed by the bankruptcy court (Pet. 36a). Under agreements with asset purchasers, "Reorganized" was added to six of the debtors' former corporate names (in the court of appeals the parties incorrectly identified each name as including the word "Reorganized"). Respondents' correct names are: Reorganized CF&I Fabricators of Utah, Inc., Colorado & Utah Land Company, Kansas Metals Company, Albuquerque Metals Company, Reorganized Pueblo Metals Company, Denver Metals Company, Reorganized Pueblo Railroad Service Company, Reorganized CF&I Fabricators of Colorado, Inc., Reorganized CF&I Steel Corporation, and The Reorganized Colorado & Wyoming Railway Company.

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UNITED STATES OF AMERICA,

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Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

Respondents, Reorganized CF&I Fabricators of Utah, Inc., Colorado & Utah Land Company, Kansas Metals Company, Albuquerque Metals Company, Reorganized Pueblo Metals Company, Reorganized Pueblo Railroad Service Company, Denver Metals Company, Reorganized CF&I Fabricators of Colorado, Inc., Reorganized CF&I Steel Corporation, and The Reorganized Colorado and Wyoming Railway Company (the "Reorganized Debtors"), respectfully request that this Court deny the petition of the United States for a writ of certiorari (the "Petition") to review a judgment of the United States Court of

Appeals for the Tenth Circuit in this case. The opinion below is reported at 53 F.3d 1155. As discussed below, this case involves matters which were correctly decided in the lower courts and do not present "special and important reasons" which warrant granting certiorari. S. Ct. R. 10.1.

STATUTES INVOLVED

The statutes involved are 11 U.S.C. §§ 507(a)(7)(E)(i), 510(c), 1122(a), 1123(a)(1), 1123(a)(4), 1129(a)(7), 1129(b)(1), and 502(j), and 26 U.S.C. § 4971(a). The relevant portions of these statutes are set forth in Respondents' Appendix ("Resp. App."), *infra*, at 7a-14a.

STATEMENT OF THE CASE

The Reorganized Debtors are ten bankrupt corporations liquidating their assets for the benefit of creditors under a Chapter 11 plan of reorganization (the "Plan of Reorganization") (Pet. 22a-37a).[2] Proceeds of the liquidation have been and will be distributed to creditors under the direction of a representative of creditors appointed by the bankruptcy court (*id.*). Because the Reorganized Debtors are deeply insolvent, general unsecured creditors who suffered hundreds of millions of dollars in actual pecuniary losses will be paid only a small percentage of their claims. The interests of former stockholders have been canceled and stockholders will receive nothing (Resp. App. 3a-4a).

The Reorganized Debtors' predecessor corporations filed bankruptcy because they could not fund two pension plans.[3] Their largest creditor is the Pension Benefit Guaranty

2. Chapter 11 of the Bankruptcy Code expressly authorizes liquidating plans. 11 U.S.C. § 1123(a)(5)(D).

3. The bankruptcy court found that the debtors had a multitude of (Cont'd)

Corporation (the "PBGC"), which took over the larger of two underfunded pension plans and as a result holds a general unsecured claim of over $220 million (subject to possible reduction depending on the outcome of pending litigation concerning the discount rate to be used to calculate the claim).[4]

The IRS's claim at issue here is a 10% penalty imposed under 26 U.S.C. § 4971 ("Section 4971") because the Reorganized Debtors' predecessor corporations failed timely to make a pension plan funding payment that came due before they filed bankruptcy. Section 4971 imposes 10% and 100% penalties for failure to meet pension minimum funding obligations (Resp. App. 13a-14a). The IRS sought priority payment as "excise taxes" of both 10% and 100% penalties (multiplied for each succeeding year of underfunding) in excess of $40 million (Pet. 45a).[5] Except for the smallest penalty, *i.e.*, a 10% penalty for the first year, the IRS has abandoned all of its other 10% and 100% penalty claims, even though its argument for "excise tax" priority for those claims was exactly the same as its argument for "excise

(Cont'd)
financial problems in addition to the claims of the Internal Revenue Service (the "IRS") and did not file bankruptcy solely to deal with the IRS's claims or to avoid payment of tax penalties (Resp. App.3a, 4a-5a).

4. *Pension Benefit Guaranty Corporation v. Reorganized CF&I Fabricators of Utah Inc. (In re CF&I Fabricators of Utah, Inc.)*, 179 B.R. 704 (D. Utah 1994). The Plan of Reorganization provided for the full funding of the other, smaller pension plan. Under provisions of the Plan of Reorganization not appealed by the IRS, all claims relating to that plan, including the IRS's penalty claims of some $36,577 (Pet. 44a), are deemed satisfied and are no longer at issue.

5. The Section 4971 penalties for the second year would be 20% and 200%, respectively, and so on, year after year (Pet. 45a). They were assessed in addition to the PBGC's claim for the missed minimum funding payments that is included as part of its $220 million general unsecured claim.

tax" priority for the single 10% penalty claim asserted here. This relieves the IRS from having to argue that the 100% penalty claims are entitled to recovery and priority as "excise taxes."

The IRS suffered no pecuniary loss from the missed payments because the purpose of Section 4971 is not to raise revenue but to encourage pension funding.[6] The PBGC, not the United States Treasury, will fund shortfalls in the underfunded pension plan (Pet. 3 n.4). On November 25, 1992, the bankruptcy court denied priority to the IRS's penalty claims (Pet. 38a-62a, published as *In re CF&I Fabricators of Utah, Inc.*, 148 B.R. 332 (Bankr. D. Utah 1992)).

The debtors proposed, in the Plan of Reorganization, to go out of business, liquidate their assets, and distribute the proceeds to creditors. A Chapter 11 plan must designate classes of claims "subject to section 1122" of the Bankruptcy Code. 11 U.S.C. § 1123(a)(1). A class of claims may include only claims that are "substantially similar." 11 U.S.C. § 1122(a).

Accordingly, the Plan of Reorganization created a class of general unsecured claims consisting entirely of claims for actual pecuniary losses (such as the PBGC's claim) and a separate class for penalties not in compensation for actual pecuniary losses (including the IRS's penalty claims). The bankruptcy court found that the Plan of Reorganization complied with the classification requirements of 11 U.S.C. § 1123(a) (Pet. 27a).

Since the Plan of Reorganization will not pay holders of general unsecured claims in full, any payment to the IRS for its

6. The lower courts found that the IRS's claims are not for any pecuniary loss (Pet. 6a, 18a, 47a, 52a, 62a; Resp. App. 3a) and the IRS has not questioned that determination. The IRS formerly asserted, and the courts below denied (Pet. 4a, 9a, 62a), priority under Section 507(a)(7)(G) (now codified at 11 U.S.C. § 507(a)(8)(G)) (penalty in compensation for actual pecuniary loss).

penalty claims would reduce, dollar for dollar, distributions to holders of general unsecured claims who suffered pecuniary losses, principally the PBGC as the largest creditor and, consequently, retirees covered by the pension plan. These are the very parties intended to be protected by statutes requiring pension funding such as Section 4971.[7] The Plan of Reorganization therefore gave the IRS's penalty claims a lower distributive priority than that given to the general unsecured claims of the PBGC and other creditors who suffered actual pecuniary losses.

The bankruptcy court found that allowing the IRS the same distributive priority as the PBGC and other general unsecured creditors would advance neither the legislative purpose of Section 4971 nor the principle of equality of distribution that underlies the Bankruptcy Code. Instead it would punish creditors, principally the PBGC (Resp. App. 4a).[8]

Under 11 U.S.C. § 1129(a)(7)(A)(ii), the bankruptcy court

7. Payments to the PBGC in this case will in part reimburse the PBGC and in part go to retirees to pay retirement benefits not covered by the PBGC's guaranty limits. By contrast, any payments to the IRS on its penalty claims would be added to general revenues in the United States Treasury and would not be paid to the PBGC, the pension plan, or retirees. 26 U.S.C. § 7809.

8. *Cf. Simonson v. Granquist*, 369 U.S. 38, 40-41 (1962) ("[T]he prohibition of all tax penalties in bankruptcy [under former law] is wholly consistent with the policy of the penalty provisions themselves. Tax penalties are imposed at least in part as punitive measures against persons who have been guilty of some default or wrong. Enforcement of penalties against the estates of bankrupts, however, would serve not to punish the delinquent taxpayers, but rather their entirely innocent creditors."); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another."); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941) ("[T]he theme of the Bankruptcy Act is equality of distribution.").

was required to find that impaired creditors would receive at least as much under the Plan of Reorganization as they would receive if the debtors were liquidated under Chapter 7. In contrast to Chapter 11 cases where non-consensual subordination of claims requires a court order, non-pecuniary loss penalties are automatically subordinated in Chapter 7 cases. 11 U.S.C. § 726(a)(4). In the particular circumstances of the debtors' Chapter 11 cases (which, as the bankruptcy court found, parallel those of a Chapter 7 case and warrant subordination of the IRS's non-pecuniary loss penalties (Resp. App. 3a-5a)), the Plan of Reorganization subordinated the IRS's penalty claims by giving them a lower distributive priority than the claims of creditors who suffered actual pecuniary losses. The Bankruptcy Court found that the Plan of Reorganization satisfied the requirements of 11 U.S.C. § 1129(a)(7) (Pet. 28a).

The bankruptcy court approved the Plan of Reorganization, finding among other things that the Plan of Reorganization was proposed in good faith and in compliance with the Bankruptcy Code (Pet. 27a) and that as to impaired classes of claims that did not accept the Plan of Reorganization (such as the class that included the IRS's penalty claims) the Plan of Reorganization did not "discriminate unfairly" and was "fair and equitable" as required by 11 U.S.C. § 1129(b)(1) (Pet. 28a).

The bankruptcy court also granted the debtors' summary judgment motion in their adversary proceeding to subordinate, pursuant to 11 U.S.C. § 510(c), the IRS's non-pecuniary loss penalty claims to the claims of general unsecured creditors who suffered pecuniary losses (Pet. 20a-21a). The bankruptcy court found that under the "unique facts presented in this case" the IRS's non-pecuniary loss claims properly should be subordinated to the claims of creditors who suffered pecuniary losses (Resp. App. 5a). The lower courts therefore did not subordinate the IRS's penalty claims based on "beliefs" or vague notions of

fairness as the Petition suggests (Pet. 9 n.6, 12, 18) but rather subordinated the claims based on detailed factual findings.

The bankruptcy court's order expressly incorporated findings made at the hearing on subordination (Pet. 20a). The Petition omits specific factual findings, summarized below, of the unique facts in this case that justify subordination of the IRS's penalty claims: The debtors did not file bankruptcy to avoid payment of IRS penalties and had a multitude of other financial problems. These Chapter 11 cases do not involve a reorganization of a continuing business. The Plan of Reorganization is a liquidation of assets of insolvent debtors, proposed after a two-year consideration of other options. Creditors who suffered actual pecuniary losses will be paid only a small portion of their claims and stockholders, whose shares have been canceled, will receive nothing. The IRS's claim is a penalty intended to punish the debtors which, if paid on these facts, would divert funds from and thereby punish the very creditors (*i.e.*, the PBGC and retirees) intended to be protected by pension funding requirements. Such payment would defeat the purpose of the statute that created the penalty. This case involves penalties that are not in compensation for any pecuniary loss to the IRS. If paid, the penalties would be paid by creditors who did suffer a pecuniary loss and had nothing to do with the missed payments, defeating the purpose of the bankruptcy laws to foster an equitable distribution. The bankruptcy court's findings are set forth in full in Respondents' Appendix at 1a-6a.

The district court and court of appeals affirmed the bankruptcy court's orders (Pet. 10a-11a, 1a-9a). The IRS sought, but was denied, a stay pending appeal (Pet. 14a). In a separate proceeding in these bankruptcy cases, the district court found that the Plan of Reorganization has been substantially consummated and that challenges to the confirmation order have become moot, at least insofar as they seek to upset sales transactions and

property transfers that have taken place in reliance on the confirmation order. *United Mine Workers of America Combined Fund v. CF&I Fabricators of Utah, Inc.* (*In re CF&I Fabricators of Utah, Inc.*), 169 B.R. 984 (D. Utah 1994).

REASONS FOR DENYING THE WRIT

This case does not present special and important reasons which warrant granting certiorari. There is no constitutional question, no conflict with this Court's decisions, and no error in statutory interpretation or application. Any apparent conflict between the Tenth and Sixth Circuits as to "excise tax" priority is insignificant because dispositive statutory language not analyzed by either court requires the same result reached by the court of appeals in this case. This case does not present a conflict with any other court of appeals on the matter of subordinating a non-pecuniary loss penalty without priority. The unique facts of this case are not of substantial recurring importance and the court of appeals' decision on these facts does not significantly affect the administration of the bankruptcy laws.

I.

THE TENTH CIRCUIT'S DECISION PRESENTS NO CONSTITUTIONAL QUESTION, IS NOT IN CONFLICT WITH ANY DECISION OF THIS COURT, AND CORRECTLY DECIDES THE STATUTORY ISSUES.

A. Priority under Section 507(a)(7)(E).

This case does not involve any issues of constitutional law. It involves interpretation of the Bankruptcy Code.

This Court has not addressed the priority granted by 11 U.S.C. § 507(a)(7)(E) for excise taxes on transactions. The Tenth Circuit correctly denied the IRS its claimed priority under

Section 507(a)(7)(E), which grants priority to governmental claims "*only to the extent that* such claims are for . . . an excise tax (emphasis added)."

The words "only to the extent that" and the absence of any Bankruptcy Code definition of "excise tax" presuppose inquiry into the nature of claims alleging excise tax priority. Nothing in the Bankruptcy Code limits the principle established under former bankruptcy law that bankruptcy courts may inquire and decide whether governmental claims are entitled to bankruptcy priority as taxes, regardless of labels in non-bankruptcy statutes, state or federal. *See, e.g., City of New York v. Feiring*, 313 U.S. 283 (1941) (whether state "sales tax" was "tax" entitled to bankruptcy priority depended on its characteristics rather than its denomination); *United States v. State of New York*, 315 U.S. 510 (1942) (labels in the Social Security Act did not foreclose inquiry into whether claims were entitled to priority in bankruptcy as a tax).

Here the inquiry was not difficult because the IRS acknowledged that legislative history and legislative intent indicate that claims under 26 U.S.C. § 4971 are in reality penalties (Pet. 47a). The disputed issue before the bankruptcy court was, therefore, not the true nature of the exaction under Section 4971(a). The dispute in this case arose over the IRS's argument that its claims, 10%, 100%, and annual multiples thereof, were automatically, and without any inquiry into their nature, entitled to "excise tax" priority under the Bankruptcy Code solely because they arise under an Internal Revenue Code section that labels them a "tax" and because that section appears under a subtitle heading containing the words "excise taxes" even though to grant them such a priority would produce results directly at odds with both the Bankruptcy Code and Section 4971 (Pet. 49a-52a, Resp. App. 4a). The bankruptcy court, district court, and court of appeals correctly rejected the IRS's argument.

The decisions of the courts below in this case are consistent with the Bankruptcy Code's treatment of penalties, which receive priority only if they are "in compensation for actual pecuniary loss," 11 U.S.C. § 507(a)(7)(G) (now § 507(a)(8)(G)), or are incurred after bankruptcy by the bankruptcy estate, 11 U.S.C. § 503(b)(1)(C).

B. Equitable subordination.

This Court has not addressed subordination of non-pecuniary loss claims for statutory penalties under either 11 U.S.C. § 510(c) or other provisions of the Bankruptcy Code. Under former law, penalty claims such as the IRS's claim in this case were disallowed outright. 11 U.S.C. § 93j (repealed 1978); *Simonson v. Granquist*, 369 U.S. 38 (1962). Therefore, equitable subordination of such claims was never addressed under former law.

This Court's equitable subordination decisions in *Comstock v. Group of Institutional Investors*, 335 U.S. 211 (1948); *Pepper v. Litton*, 308 U.S. 295 (1939); and *Taylor v. Standard Gas & Electric Co.*, 306 U.S. 307 (1939) are distinguishable on their facts. Those cases involved issues concerning subordination of claims for actual pecuniary loss, not claims for penalties. The decision of the court of appeals in this case is therefore not inconsistent with those decisions.

Equitable subordination in *Pepper* and *Taylor* protected innocent creditors from harm by subordinating the claims of creditors who violated fiduciary obligations and mismanaged corporate affairs. Subordination of the IRS's claims in this case also protected innocent creditors from harm by refusing to punish them for the debtors' violation of ERISA (through failure to make a statutorily required payment).[9] The Tenth Circuit's decision in

9. The IRS repeatedly asserts its own innocence (Pet. 12, 18, 20) but it

(Cont'd)

this case is not a departure from established precedent, but instead is a similar application of equitable principles to a situation which had not arisen under prior law because prior law disallowed federal non-pecuniary loss penalties entirely.[10]

The court of appeals' decision is faithful to the text of Section 510(c), which expressly permits subordination of claims "for purposes of distribution" based on "principles of equitable subordination." The decision in this case did not, as the IRS suggests, assume authority (Pet. 12, 18), but rather exercised a power explicitly granted by Congress in Section 510(c). The court of appeals correctly rejected the IRS's non-textual arguments for limits on Section 510(c). Despite the IRS's arguments, the text of Section 510(c) does not require a finding of inequitable conduct or freeze principles of equitable subordination in time by forever terminating the power of courts to make precedents in new circumstances (*e.g.*, the subordination of penalties which formerly had been disallowed by statute).

(Cont'd)

suffered no loss and its attempt to take money from the PBGC and retirees, who suffered a huge loss, undermines that assertion.

10. "[T]here is an undeniable equity in the postulate that participation in the estate should be denied to a creditor who has neither in some degree contributed to the distributable funds . . . nor has suffered a pecuniary loss by parting with something in money's worth." 3 Collier on Bankruptcy ¶ 57.22[1] at 382 (14th ed. 1977) (discussing disallowance of penalties under former law).

II.

ANY APPARENT CONFLICT BETWEEN THE TENTH AND SIXTH CIRCUITS ON THE INTERPRETATION OF SECTION 507(a)(7)(E) IS NOT SIGNIFICANT BECAUSE DISPOSITIVE LANGUAGE OF SECTION 507(a)(7)(E) LIMITING THE EXCISE TAX PRIORITY IN BANKRUPTCY TO CASES INVOLVING A "TRANSACTION OCCURRING," AND REQUIRING THE SAME RESULT REACHED IN THE TENTH CIRCUIT, WAS NOT ANALYZED BY EITHER COURT OF APPEALS.

The IRS's claim is not based on a "transaction occurring" as required by the plain language of Section 507(a)(7)(E), but instead is based solely on the non-occurrence of a required pension plan contribution. 11 U.S.C. § 507(a)(7)(E). The IRS's argument for priority therefore lacks merit. The IRS ignores the plain language of Section 507(a)(7)(E) requiring that a governmental claim asserting "excise tax" priority arise on the basis of a "transaction occurring" and instead asserts an unqualified priority based on broad phrases in legislative materials (Pet. 13, 15, 16-17).

A decision by this Court on the arguments presented in the Petition would not resolve the dispositive issue of whether the statutory requirement of a "transaction occurring" is satisfied by a simple failure to fund a pension plan. That issue, although raised by the Reorganized Debtors in the court of appeals in this case, was not addressed by the court of appeals. The Sixth Circuit did not address this issue in *Mansfield* except to conclude, in a footnote without analysis, that the argument had no merit. *United States v. Mansfield Tire & Rubber Co.*, 942 F.2d 1055, 1059 at n.4 (6th Cir. 1991), *cert. denied sub nom. Krugliak v. United States*, 502 U.S. 1092 (1992). Further litigation in the courts of appeals should be permitted to address this dispositive issue.

III.

THERE IS NO CONFLICT IN THE COURTS OF APPEALS ON THE INTERPRETATION OF SECTION 510(c), AND THE PARTICULAR FACTUAL CIRCUMSTANCES OF THIS CASE PRESENT ALTERNATIVE STATUTORY GROUNDS FOR GRANTING THE IRS'S CLAIM A LOWER DISTRIBUTIVE PRIORITY.

Lower court rulings on the subordination of penalty claims in a case such as this are not in conflict. The courts of appeals are unanimous in agreement with the court of appeals in this case that, in the narrow context of non-pecuniary loss penalties, equitable subordination under 11 U.S.C. § 510(c) does not require a finding of inequitable conduct. *United States v. Noland*, 48 F.3d 210 (6th Cir. 1995), *petition for cert. filed*, 64 U.S.L.W. 3161 (U.S. Aug. 24, 1995) (No. 95-323); *Burden v. United States*, 917 F.2d 115 (3d Cir. 1990); *Schultz Broadway Inn v. United States*, 912 F.2d 230 (8th Cir. 1990); *In re Virtual Network Services Corp.*, 902 F.2d 1246 (7th Cir. 1990).

The decision of the court of appeals in this case does not, as the Petition incorrectly argues (Pet. 12, 21), broaden any perceived conflict among other courts of appeals on subordination of claims that qualify for a Section 507 priority. The court of appeals in this case first found that the IRS's claim was not entitled to priority under Section 507 and then addressed only subordination of the IRS's claim as a claim not entitled to priority under Section 507, stating that it "need not discuss" subordination of a claim entitled to Section 507 priority (Pet. 6a).

Under the particular facts of this case, the lower distributive priority given the IRS's claim is fully justified under statutes other than Section 510(c), including those governing a Chapter 11 plan, 11 U.S.C. §§ 1122(a), 1123(a)(1), 1123(a)(4),

1129(a)(7), and 1129(b)(1), and 11 U.S.C. § 502(j). Section 1122(a) requires a Chapter 11 plan to classify separately claims that are not "substantially similar." It is self-evident that claims for a pecuniary loss are not substantially similar to claims that do not represent a pecuniary loss. Section 1123(a)(1) requires that a Chapter 11 plan designate classes of claims. Section 1123(a)(4) requires that a Chapter 11 plan treat claims within a class equally. Section 1129(a)(7) requires a Chapter 11 plan to provide non-accepting impaired classes of claims at least as much as if the debtor were liquidated under Chapter 7.[11] Section 1129(b)(1) requires confirmation of an otherwise confirmable Chapter 11 plan that does not "discriminate unfairly" among classes of claims and is "fair and equitable."

In these statutes the Bankruptcy Code expressly authorizes bankruptcy courts to consider the circumstances of the case, including the nature of the claims involved and fairness and equity, in the context of the distributive priority of claims. Furthermore, Section 502(j) gives bankruptcy courts full equity powers to allow or disallow claims that previously have been allowed or disallowed "according to the equities of the case."[12] This Court, in *Pepper v. Litton*, 308 U.S. 295 (1939), held that the express power granted under Section 502(j)'s predecessor (Bankruptcy Act Section 57k, 11 U.S.C. § 93k (repealed 1978)) to reconsider claims based on the equities of the case implies that "disallowance or subordination in light of equitable considerations may originally be made." 308 U.S. at 305.

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11. Chapter 7 automatically subordinates claims for penalties that "are not compensation for actual pecuniary loss suffered by the holder of such claim." 11 U.S.C. § 726(a)(4).

12. The IRS's claims were "deemed allowed" when filed, subject to objection. 11 U.S.C. § 502(a).

These separate statutes, as the Reorganized Debtors argued in the court of appeals, authorized the bankruptcy court to consider the equities of this case and grant the IRS's non-pecuniary loss penalty claim a lower distributive priority than that granted to the claims of creditors who suffered pecuniary losses. Therefore, this case is not a suitable case for determining the extent of "principles of equitable subordination" under Section 510(c). Neither the court of appeals below nor the Sixth Circuit in *Mansfield, supra*, analyzed these dispositive statutes other than Section 510(c).

IV.

THE QUESTIONS PRESENTED DO NOT SIGNIFICANTLY AFFECT THE ADMINISTRATION OF THE BANKRUPTCY LAWS AND ARE NOT OF SUBSTANTIAL, RECURRING IMPORTANCE.

While bankruptcy claims for excise tax priority in general may be litigated frequently, since the Bankruptcy Code became effective in 1979, the IRS's claim to priority for a Section 4971(a) penalty has only been addressed in two courts of appeals, the court below and the Sixth Circuit in *Mansfield, supra*. The bankruptcy court correctly found that this case presents unique facts for equitable subordination (Resp. App. 5a). These unusual circumstances are not of substantial, recurring importance.

REASONS FOR NOT REVIEWING THIS CASE IN TANDEM WITH *UNITED STATES V. NOLAND*

The issue presented in *United States v. Noland*, 48 F.3d 210 (6th Cir. 1995), *petition for cert. filed*, 64 U.S.L.W. 3161 (U.S. Aug. 24, 1995) (No. 95-323) is not "closely analogous" to the issues in this case as stated in the Petition (Pet. (I)). In *Noland*, the court subordinated a penalty claim for unpaid *post-*

bankruptcy social security and unemployment taxes that had priority under Bankruptcy Code Section 503(b)(1)(C) (giving priority to post-bankruptcy penalties). In this case, the primary issue is whether the IRS's *pre-bankruptcy* penalty claim, under a different statute, for failing to make a pension funding payment, has statutory priority at all under Bankruptcy Code Section 507(a)(7)(E) which limits priority to an "excise tax on a transaction occurring."

Once the courts below determined that the IRS's claim is a general unsecured claim without statutory priority, the subordination in this case did not raise unusual legal issues. Furthermore, the lower distributive priority given to the IRS's claim in this case was fully justified under statutes governing Chapter 11 plans, none of which apply in *Noland*, a Chapter 7 case. Neither an affirmance nor a reversal of the *Noland* decision by this Court should have an effect on the outcome in this case.

REASONS FOR LIMITING REVIEW IF THE PETITION IS GRANTED

If the Court grants the Petition, review of the order confirming the Plan of Reorganization should be limited to the distributive priority of the IRS's claim and should exclude any other matter pertaining to the confirmation order. Insofar as the Petition may seek total reversal of the order confirming the Plan of Reorganization (and reversal of multi-million dollar property sales and payments that have taken place in reliance on the confirmation order), that challenge to the confirmation order has become moot, as the district court has found in another proceeding in the Reorganized Debtors' bankruptcy cases. *United Mine Workers of America Combined Fund v. CF&I Fabricators of Utah, Inc.* (*In re CF&I Fabricators of Utah, Inc.*), 169 B.R. 984 (D. Utah 1994). The IRS can obtain full relief as to its penalty claim (*i.e.*, priority as an excise tax or a general

unsecured claim) if review is limited to the matters of distributive priority argued in the Petition. The Plan of Reorganization as confirmed provides for full payment of priority tax claims and provides that if non-priority penalty claims are not subordinated they will be treated along with other general unsecured claims.

CONCLUSION

The Court should deny the Petition.

Respectfully submitted,

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APPENDIX A — TRANSCRIPT OF THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF UTAH, CENTRAL DIVISION DATED JANUARY 28, 1993

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

Bankruptcy No. 90B-06721

Chapter 11

In re:

CF&I FABRICATORS OF UTAH, INC.,

DEBTOR.

BEFORE THE HONORABLE JUDITH A BOULDEN

January 28, 1993

APPEARANCES OF COUNSEL:

For the Debtor:	Steven C. Strong Attorney at Law 136 South Main Street Salt Lake City, Utah
For the Unsecured Creditors Committee:	Steven T. Waterman Attorney at Law 79 South Main Street Salt Lake City, Utah
For the IRS:	Mark Howard Attorney at Law 125 South State Street Salt Lake City, Utah

[3] Salt Lake City, Utah January 28, 1993

THE CLERK: This is in the matter of CF&I Fabricators of Utah.

THE COURT: Counsel, state your appearances.

MR. WATERMAN: Steven T. Waterman, of Ray, Quinney and Nebeker, appearing on behalf of the Unsecured Creditors' Committee.

MR. STRONG: Steven C. Strong, of LeBoeuf, Lamb Leiby and MacRae, appearing on behalf of the debtors.

MR. HOWARD: Mark Howard, Special Assistant United States Attorney, appearing for the Internal Revenue Service.

THE COURT: Counsel, the matter that is before the Court today is the debtor's motion for summary judgment in the adversary proceeding filed against the Internal Revenue Service. I had indicated last night on the record that I would enter a ruling on the record today. If there are comments or further argument that the parties wish to make at this point, I'm certainly willing to entertain it.

MR. WATERMAN: I would just indicate, Your Honor, that the order granting the Unsecured Creditors' Committee intervention was just signed. We have not filed anything, but I think Your Honor understands that we do support the position of the plaintiff.

THE COURT: All right. Is there anything further then? All right. Initially let me indicate that this is a [4] core matter. It is one

that arises in and relates to CF&I's bankruptcy case and claims that have been filed against the debtor. In this adversary proceeding the debtor requests that the claims filed by the Internal Revenue Service for non pecuniary loss penalties be equitably subordinated to the claims of the general unsecured creditors pursuant to section 510(C) of the code. After review of the pleadings submitted by both parties, and now as indicated by Mr. Waterman also, and the representations of counsel, I'll find that there is no genuine issue of fact that is material to this litigation that is disputed, and I will also find that the debtors are entitled to summary judgment as a matter of law. Even though there are no uncontested disputed facts, let me indicate for the record the factual circumstances that I'm basing the ruling on.

The debtors have been under the jurisdiction of the Court in Chapter 11 for over two years. The debtors are insolvent. The debtors have a multitude of financial problems in addition to the claims of the Internal Revenue Service. And the filing arises not solely to deal with the Internal Revenue claims. The debtors have proposed and have now confirmed a liquidating plan that pays only a small portion of unsecured claims and does not return any amount to equity interest holders. The Internal Revenue Service's claim is for non pecuniary loss penalties as a result of the [5] debtors failure to pay minimum funding requirements to its two pension plans. Any payment to the Internal Revenue Service on these claims would reduce the payment to general unsecured claims, including the PBGC. And I'll also find — make a finding that there has been no inequitable conduct on the part of the Internal Revenue Service.

As section 510(C) applies to the facts of this case, it is appropriate to equitably subordinate the Internal Revenue Service penalty claims to the claims of unsecured creditors,

including the unsecured claims of the PBGC. Unsecured claimants will receive only a small percentage of their total claims, and equity interest holders are receiving no distribution. Allowing the substantial Internal Revenue penalty claims to participate as a general unsecured claim will effectively reduce the PBGC's recovery on the unsecured portion of its claim for the pension plan, underfunding the very claims upon which the Internal Revenue Service assesses. Section 49-71 penalties allowing the Internal Revenue Service to share in the distribution to unsecured creditors on the same basis as the pecuniary loss claims of the PBGC does not advance the legislative purpose of section 49-71 of the Internal Revenue Code or the general principal of fair sharing among creditors advanced by the Bankruptcy Code. Instead, it punishes creditors of the debtors rather than punishing the debtors.

[6] Contrary to the assertion of the Internal Revenue Service that equitable subordination under section 510(C) requires a showing of inequitable behavior on behalf of the creditor, I reach the conclusion that the section 49-71 penalty should be subordinated, whether or not the taxing authority engaged in any misconduct.

In this case, as I indicated, I find no showing of inequitable conduct on the part of the Internal Revenue Service or that there is any need for such showing under the circumstances of this case. The IRS asserts that subordination of tax penalties is relegated to Chapter 7, absent a showing of misconduct. In this case, where the debtors propose a liquidating Chapter 11 case with no distribution to equity interest holders and only partial payment to unsecured creditors, the treatment for non pecuniary loss penalties should not be different than that under a Chapter 7 proceeding. Although this case resulted in liquidation, the

debtors filed for reorganization to accomplish several other purposes other than avoiding payment of tax penalties. After nearly two years of serious consideration of a variety of options, the debtors concluded that a sale of substantially all of the estate assets to a single buyer was the only feasible method of rehabilitation.

Based upon the unique facts presented in this case, and in the absence of any genuine issue of material fact, the [7] judgment in favor of the debtors is granted on all causes of action contained in the complaint. Mr. Strong, would you prepare judgment to that effect?

MR. STRONG: Yes.

THE COURT: Is there anything further? Thank you.

MR. HOWARD: Your Honor, I presume from what you have stated on the record that the confirmation order was entered last night then? I did not stay for the entire hearing. There were additional matters going on on other claims.

THE COURT: Counsel, I did not execute a confirmation order last night. I did confirm the plan, ruled on a number of other issues, made findings of fact and conclusions of law on the record. Mr. McCardell indicated that they had a number of other orders that he needed entered in addition to a ruling under Section 1129 that he needed in order to effectuate consummation of the plan of reorganization. He indicated those on the record. There were no objections to entering them. Some of the issues had to do about whether or not Oregon Steel was a good faith purchaser. Those kinds of things. He indicated that he would draft the order of confirmation and the ancillary orders and would circulate them

to the individuals that were indicated on the roster. And after the time had passed for objection to the form of the order, then I'll execute it. [8] So, in answer to your question, I confirmed the plan, but there was no order executed yesterday. So the appeal time has not yet started to run.

MR. HOWARD: Thank you.

THE COURT: Is there anything further? We'll be in recess.

(Recess.)

APPENDIX B — RELEVANT STATUTES

Bankruptcy Code (11 U.S.C.) (the Bankruptcy Code was amended by Pub. L. No. 103-394, 108 Stat. 4106 (Oct. 22, 1994), but because those amendments do not affect this case the pre-amendment version of each applicable statute is given below):

§ 502. Allowance of claims or interests

* * *

(j) A claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim may be allowed or disallowed according to the equities of the case. Reconsideration of a claim under this subsection does not affect the validity of any payment or transfer from the estate made to a holder of an allowed claim on account of such allowed claim that is not reconsidered, but if a reconsidered claim is allowed and is of the same class as such holder's claim, such holder may not receive any additional payment or transfer from the estate on account of such holder's allowed claim until the holder of such reconsidered and allowed claim receives payment on account of such claim proportionate in value to that already received by such other holder. This subsection does not alter or modify the trustee's right to recover from a creditor any excess payment or transfer made to such creditor.

§ 507. Priorities

(a) The following expenses and claims have priority in the following order:

* * *

(7) Seventh, allowed unsecured claims of governmental units; only to the extent that such claims are for —

* * *

(E) an excise tax on —

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

* * *

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

* * *

§ 510. Subordination

* * *

(c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may —

(1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or

(2) order that any lien security such a subordinated claim be transferred to the estate.

§ 1122. Classification of claims or interests

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other

claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

§ 1123. Contents of plan

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall —

(1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a)(1), 507(a)(2), or 507(a)(7) of this title, and classes of interests;

* * *

(4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

* * *

(7) With respect to each impaired class of claims or interests —

(A) each holder of a claim or interest of such class —

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in

the property that secures such claims.

* * *

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

Internal Revenue Code (26 U.S.C.):

§ 412. Minimum Funding Standards.

(a) **General Rule.** — Except as provided in subsection (h), this section applies to a plan if, for any plan year beginning on or after the effective date of this section for such plan —

(1) such plan included a trust which qualified (or was determined by the Secretary to have qualified) under section 401(a), or

(2) such plan satisfied (or was determined by the Secretary to have

satisfied) the requirements of section 403(a).

A plan to which this section applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year, the plan does not have an accumulated funding deficiency. For purposes of this section and section 4971, the term "accumulated funding deficiency" means for any plan the excess of the total charges to the funding standard account for all plan years (beginning with the first plan year to which this section applies) over the total credits to such account for such years or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years. In any plan year in which a multiemployer plan is in reorganization the accumulated funding deficiency of the plan shall be determined under section 418B.

§ 4971. Taxes on Failure to Meet Minimum Funding Standards.

(a) Initial Tax. — For each taxable year of an employer who maintains a plan to which section 412 applies, there is hereby imposed a tax of 10 percent (5 percent in the case of a multiemployer plan) on the amount of the accumulated funding deficiency under the

plan, determined as of the end of the plan year ending with or within such taxable year.

(b) Additional Tax. — In any case in which an initial tax is imposed by subsection (a) on an accumulated funding deficiency and such accumulated funding deficiency is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of such accumulated funding deficiency to the extent not corrected.

(c) Definitions. — For purposes of this section —

(1) Accumulated funding deficiency — The term "accumulated funding deficiency" has the meaning given to such term by the last two sentences of section 412(a).

(9)

No. 95-325

In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

REORGANIZED CF&I FABRICATORS OF UTAH, ET AL.

---

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT*

REPLY BRIEF FOR THE UNITED STATES

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TABLE OF AUTHORITIES

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

1. a. Respondents do not dispute that a conflict among the circuits exists on the first question presented in this case. The decision of the Tenth Circuit in this case conflicts directly with the decision of the Sixth Circuit in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (1991), cert. denied *sub nom. Krugliak* v. *United States*, 502 U.S. 1092 (1992). In *Mansfield Tire*, the Sixth Circuit held that an excise tax claim under Section 4971 of the Internal Revenue Code is entitled to the priority afforded excise taxes under Section 507(a)(7)(E) of the Bankruptcy Code. 942 F.2d at 1059. In the present case,

the Tenth Circuit held precisely to the contrary. See Pet. App. 4a-6a.

b. Unable to dispute the existence of this direct conflict, respondents attempt to minimize its significance. They argue that the conflict is unimportant because, in their view (Br. in Opp. 12), the cases could have been resolved under the theory that Section 507(a)(7)(E) grants priority only to claims for excise taxes on a "transaction" and that Section 4971 does not impose an excise tax on a "transaction" (Br. in Opp. 12). That contention, however, was in fact considered and rejected by the Sixth Circuit in *Mansfield Tire*, 942 F.2d at 1059 n.4. Thus, even if the court of appeals had adopted respondent's additional contention, the direct conflict between the circuits would still exist.[1]

c. Respondents concede (Br. in Opp. 15) that the question of the proper priority to be afforded to excise tax claims is litigated frequently. See, *e.g.*, *Seidle* v. *United States (In re Airlift International, Inc.)*, 120 B.R. 597 (S.D. Fla. 1990); *United Steelworkers of America* v. *PBGC (In re Wheeling-Pittsburgh Steel Corp.)*, 103 B.R. 672 (W.D. Pa. 1989). Indeed, excise tax claims asserted under Section 4971 alone accumulate to hundreds of millions of dollars annually.

Moreover, the issue presented in this case has consequences well beyond the Section 4971 excise tax alone. Claims for other federal excise taxes have been

[1] The Sixth Circuit correctly rejected this contention in *Mansfield Tire*. As the petition notes (Pet. 13), Congress intended the priority for excise taxes to be comprehensive in scope. See also *Groetken* v. *Illinois Dep't of Revenue*, 843 F.2d 1007, 1013-1014 (7th Cir. 1988). The "transaction" taxed under Section 4971 is the act of maintaining a pension plan that is not funded adequately.

contested on the same ground that the court of appeals sustained in this case—that the tax is "punitive" and should therefore be denied the priority that Congress expressly provided for such claims in Section 507 of the Bankruptcy Code. See, *e.g.*, *United States* v. *Juvenile Shoe Corp.*, 180 B.R. 206 (E.D. Mo. 1995), appeal pending, No. 95-2289 (8th Cir.) (excise tax under 26 U.S.C. 4980); *United States* v. *Unsecured Creditors' Committee of C-T of Virginia, Inc.*, 977 F.2d 137 (4th Cir. 1992), cert. denied, 113 S. Ct. 1644 (1993) (same); *United States* v. *Dividend Development Corp.*, No. SA CV 94-84 (C.D. Cal. Apr. 6, 1994), appeal pending, No. 94-55827 (9th Cir.) (excise tax under 26 U.S.C. 4975).

When excise tax claims are denied priority, they are paid along with general unsecured claims, typically at a fraction of their face value. And when, as in the present case, such claims are further subordinated to the claims of general unsecured creditors, the excise tax claims are paid nothing at all. The priority scheme that Congress enacted for excise tax claims is thereby entirely nullified by the decision in this case.

2. The second question presented in the petition is whether principles of equitable subordination codified in Section 510(c) of the Bankruptcy Code permit subordination of an excise tax claim in the absence of inequitable conduct by the government in obtaining or enforcing the claim.

a. Respondents err in contending that the decision in this case does not conflict with the decisions of this Court or of other circuits. This Court long ago held that bankruptcy courts may use their equitable powers to subordinate claims that creditors acquired or asserted in violation of fiduciary duties or by other-

wise acting inequitably and to the detriment of other creditors. *Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307 (1939); *Pepper* v. *Litton*, 308 U.S. 295 (1939); *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211 (1948). In the *Comstock* case, the Court made clear that equitable subordination may *not* also be used to subordinate legitimate claims of innocent creditors (335 U.S. at 229):

> It is not mere existence of an opportunity to do wrong that brings the rule into play; it is the unconscionable use of the opportunity afforded by the domination to advantage itself at the injury of the subsidiary that deprives the wrongdoer of the fruits of his wrong. On the findings in this case, the claim of [the parent] was the outgrowth of complicated but legitimate good faith business transactions, neither in design or effect producing injury to the petitioner or the interests for which he speaks.

Several of the courts of appeals have likewise recognized that "creditor misconduct" must exist for the doctrine of equitable subordination to apply. See *Benjamin* v. *Diamond*, 563 F.2d 692, 699-700 (5th Cir. 1977); *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d 784, 788 (9th Cir.), cert. denied, 423 U.S. 913 (1975). Respondents' sole basis for suggesting that these decisions do not conflict with the decision below—which subordinates the legitimate statutory claim of a blameless creditor—is that decisions such as *Comstock*, *Benjamin*, and *Stebbins* did not address whether a statutory "penalty" claim might be subordinated under principles of equitable subordination. But the enforcement of a statutory claim, enacted to *prevent* misconduct by the debtor, cannot plausibly be regarded as misconduct by the creditor.[2] Respondents thus err in suggesting that the decision in this case does not conflict with the preexisting holdings of this Court and of other circuits.

Section 510(c) of the current Bankruptcy Code did no more than codify preexisting "principles of equitable subordination." Prior to the enactment of Section 510(c), decisions such as *Comstock*, *Benjamin*, and *Stebbins* had firmly established that equitable subordination is not a license to subordinate on the basis of "abstract legislative judgments about * * * fairness" (*Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 787). By holding that equitable subordination may apply even in the absence of a "showing of inequitable behavior" (Br. in Opp. App. 4a), the decision in the present case contradicts and conflicts with that established principle.

b. Respondents advance a new contention that was not raised in the bankruptcy court or the district court and, although raised in the court of appeals, was not considered or addressed by that court. Respondents' new contention is that subordination of the government's claim might have been achieved in the present case *without* invoking principles of equitable subordination, by applying other provisions of the Bankruptcy Code. They contend (Br. in Opp. 13-15, citing 11 U.S.C. 1129(b)(1)) that the bankruptcy court *could* have confirmed their plan of reorganization, over the government's objection, solely upon a finding

[2] The fact that the creditor who asserts such a claim has not contributed to the estate is also irrelevant. Many claims are granted priority without regard to whether the claimant can establish that it has contributed assets to the estate. See 11 U.S.C. 507(a).

that it was "fair and equitable" and did not "discriminate unfairly" to treat the Section 4971 claim worse than general unsecured claims.

Of course, the courts below were not requested to—and did not—make a finding that, in the absence of equitable subordination, it would be "fair and equitable," and would not "discriminate unfairly," to omit payment of the government's claim. Instead, the court's finding that these statutory standards would be met was premised on the assumption that the government's claim was properly subject to equitable subordination (Pet. App. 28a; Br. in Opp. 17). Whether the court would have made a finding that subordination of a claim that was *not* subject to equitable subordination would satisfy these statutory standards, and what relevance such a finding might have if it had been made, are issues that this case clearly does not present. The unsupported theory that respondents belatedly seek to inject in this case has not been adopted by any court.[3] In particular, the court of

[3] The statutory term "unfair discrimination" is not defined in the Bankruptcy Code. Attempts to devise a definition have produced a variety of results. See, *e.g.*, *Michelson* v. *Lesser*, 939 F.2d 669, 672 (8th Cir. 1991); *In re Aztec Co.*, 107 B.R. 585, 590 (Bankr. M.D. Tenn. 1989); *In re Husted*, 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992). None of the decisions applying that term has subordinated a statutory penalty claim. Instead, when statutory penalty claims have been subordinated, courts have relied on the "principles of equitable subordination" that the present case involves. See, *e.g.*, *In re Apex Oil Co.*, 118 B.R. 683, 694-699 (Bankr. E.D. Mo. 1990). See also *Schultz Broadway Inn* v. *United States*, 912 F.2d 230 (8th Cir. 1990); *In re Virtual Network Services Corp.*, 902 F.2d 1246 (7th Cir. 1990).

appeals did not refer to it—much less rely on it—in this case.[4]

Instead, the court applied the "principles of equitable subordination" codified in Section 510(c) of the Code in a manner that nullifies the priority structure that Congress enacted. The conflict that exists among the courts of appeals on the proper meaning of the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code merits this Court's review.

c. Respondents suggest (Br. in Opp. 15) that "unique facts" and "unusual circumstances" make the present case inappropriate for consideration of the equitable subordination issue. They refer to a statement of the bankruptcy court (Br. in Opp. App. 5a) that allowing the Section 4971 excise tax claim on a par with general unsecured claims would reduce the amount available for distribution to holders of general unsecured claims, some of whom the bankruptcy court regarded as more worthy of payment (Br. in Opp. App. 3a-5a).

There is obviously nothing unique or unusual about the fact that, under a subjective scheme of valuation,

[4] Respondents also err in suggesting (Br. in Opp. 14) that the bankruptcy court could have subordinated the excise tax claim under the authority provided in Section 502(j) of the Bankruptcy Code to reconsider claims (11 U.S.C. 502(j)). This is another provision that respondents did not seek to invoke in the bankruptcy or district courts. In any event, Section 502(j) is simply an analogue of Rules 59 and 60 of the Federal Rules of Civil Procedure. It authorizes bankruptcy courts to reconsider the allowance or disallowance of a claim where "the equities of the case" justify reconsideration. See *Colley* v. *National Bank of Texas*, 814 F.2d 1008, 1010 (5th Cir.), cert. denied, 484 U.S. 898 (1987); *S.G. Wilson Co.* v. *Cleanmaster Industries, Inc.*, 106 B.R. 628, 630 (Bankr. 9th Cir. 1989).

some claims will appear more worthy than others. That type of personal, individualized reaction to the "worthiness" of competing claims lies at the heart of the issue that this case presents for review. This case squarely presents the question whether "principles of equitable subordination" authorize a bankruptcy court to make a subjective assessment of the relative merits of the legitimate claim of an *innocent* creditor and, based on that assessment, subordinate the claim to other claims that Congress provided should be given parity or lower priority in the statutory scheme.

3. We have suggested that, if the petitions in this case and *United States* v. *Noland*, No. 95-323, are both granted, the two cases should be set for argument in tandem because they present closely related questions concerning the proper scope of equitable subordination. Respondents, however, dispute that the issues are closely related, noting that *Noland* arises under Chapter 7 of the Bankruptcy Code and that this case arises under Chapter 11 (Br. in Opp. 16). That distinction, however, makes no difference for application of the principles of equitable subordination codified in Section 510(c), which are to apply alike in cases under both Chapters. See 11 U.S.C. 103(a).

Respondents correctly note (Br. in Opp. 16) that the *Noland* case involves the subordination of a statutory claim that the court acknowledged *is* entitled to priority under the statutes enacted by Congress. In the present case, by contrast, the court of appeals held that the statutory claim was *not* within the statutory priority category. That difference is the reason why *Noland* and the present case should be heard in tandem; neither case individually would

require the Court to address all of the issues raised by the two cases together.[5]

* * * * *

For the reasons stated above and in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

NOVEMBER 1995

[5] *Noland* does not present the first question presented in this case—the scope of the priority granted in Bankruptcy Code Section 507(a)(7)(E).

(4)

No. 95-325

In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., COLORADO & UTAH LAND COMPANY, KANSAS METALS COMPANY, ALBUQUERQUE METALS COMPANY, REORGANIZED PUEBLO METALS COMPANY, DENVER METALS COMPANY, REORGANIZED PUEBLO RAILROAD SERVICE COMPANY, REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL COPORATION, AND REORGANIZED COLORADO AND WYOMING RAILWAY COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTIONS PRESENTED

1. Whether the claim of the United States against the debtor in bankruptcy for an excise tax owed under Section 4971(a) of the Internal Revenue Code, 26 U.S.C. 4971(a), is entitled to the distributive priority for an "excise tax" accorded under Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E).[1]

2. Whether, in the absence of inequitable conduct by the government in obtaining or enforcing its claim, the excise tax claim of the United States under Section 4971(a) of the Internal Revenue Code may be subordinated to general unsecured claims under the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code, 11 U.S.C. 510(c).[2]

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[1] Section 304(c) of the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4132, added a new seventh priority for alimony and child support claims and changed the preexisting priority for excise taxes from seventh to eighth. Those amendments have no significance for the issues presented in this case.

[2] This case will be argued in tandem with *United States* v. *Noland*, No. 95-323, which presents a closely analogous question concerning the proper scope of the "principles of equitable subordination" in bankruptcy cases. We have furnished a copy of the brief for the United States in *United States* v. *Noland* to counsel for respondents in this case. We have also furnished a copy of the brief for the United States in this case to counsel for respondent in *United States* v. *Noland*.

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-9a) is reported at 53 F.3d 1155. The opinion of the district court (Pet. App. 10a-11a) is unreported. The opinion of the bankruptcy court (Pet. App. 38a-62a) is reported at 148 B.R. 332.

JURISDICTION

The judgment of the court of appeals was filed on April 27, 1995. On July 14, 1995, Justice Breyer extended the time for filing a petition for a writ of cer-

tiorari to and including August 25, 1995. The petition was filed on August 24, 1995, and was granted on December 1, 1995. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant portions of Section 507(a)(7) and 510(c) of the Bankruptcy Code, 11 U.S.C. 507(a)(7) and 510(c) (1988), and of Section 4971 of the Internal Revenue Code, 26 U.S.C. 4971, are set forth at Pet. App. 63a-66a.

STATEMENT

1. Respondents are the Reorganized CF&I Steel Corporation and its nine subsidiaries. Prior to 1990, these corporations maintained defined-benefit pension plans for their employees that were subject to the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 *et seq.* For the year that ended on December 31, 1989, respondents failed to make required pension plan contributions of $12,400,000. The plans therefore had an "accumulated funding deficiency" equal to that amount. See 26 U.S.C. 412(a). In November 1990, respondents filed petitions for reorganization under Chapter 11 of the Bankruptcy Code (Pet. App. 2a).

Subtitle D of the Internal Revenue Code is entitled "Miscellaneous Excise Taxes." One of the provisions of that subtitle—Section 4971(a) of the Internal Revenue Code—imposes a 10% excise tax on the amount of any "accumulated funding deficiency" of qualified pension plans. 26 U.S.C. 4971(a). The excise tax liability for respondents' "accumulated funding deficiency" under Section 4971(a) was therefore approximately $1,240,000. The Internal Revenue

Service filed proofs of claims for that amount in respondents' bankruptcy case (Pet. App. 2a-3a).[3]

The government's proofs of claims assert that the liability for this excise tax under Section 4971(a) of the Internal Revenue Code is entitled to seventh priority in the distribution of the assets of the debtors' estates under Section 507(a)(7)(E) of the Bankruptcy Code.[4] As applicable to this case, Section 507(a)(7)(E)

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[3] The proofs of claims filed by the United States also asserted (i) priority claims for excise taxes under Section 4971(a) for the subsequent plan year, (ii) priority claims for excise taxes under Section 4971(b) for both the 1989 and 1990 plan years, (iii) nonpriority claims for penalties related to the Section 4971(a) excise tax for 1980 and (iv) priority claims for income taxes for various years. Section 4971(b) of the Internal Revenue Code imposes an additional excise tax, equal to 100 percent of the "accumulated funding deficiency," on employers who fail to correct the deficiency within a specified period. 26 U.S.C. 4971(b). The government did not appeal the adverse rulings relating to any of those claims.

[4] The Pension Benefit Guaranty Corporation (PBGC) also filed proofs of claims in this case. The PBGC is a corporation owned by the United States that guarantees payment of certain vested benefits under terminated pension plans. See 29 U.S.C. 1301 *et seq.* The PBGC obtains funds for that purpose from insurance premiums paid by the employers whose pension plans are subject to Title IV of ERISA. See 29 U.S.C. 1306-1307 (1988 & Supp. V 1993). In March 1992, when one of the debtors' pension plans was terminated, the PBGC became the statutory trustee for the plan pursuant to 29 U.S.C. 1342. The PBGC thereby became liable to plan participants for guaranteed benefits.

The PBGC filed proofs of claims in the bankruptcy case seeking to recover unpaid pension plan contributions. The PBGC also sought to recover its own statutory claim for unfunded benefits. See 29 U.S.C. 1362(a) and (b). The PBGC asserted various priorities for its claims, including administrative tax priority under Sections 503(b)(1)(B) and 507(a)(1) of the

provides a "[s]eventh" priority for governmental claims for any "excise tax" that arose during the three years immediately preceding the date of the filing of the bankruptcy petition. See 11 U.S.C. 507(a)(7)(E)(i) and (ii) (1988); note 1, *supra*. Section 507(a)(7)(G) of the Bankruptcy Code provides the same "[s]eventh" priority to a statutory penalty that is "related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss." 11 U.S.C. 507(a)(7)(G) (1988).

Respondents filed an objection to the government's claim. They argued that the excise tax claims under Section 4971(a) were neither a "tax" nor a penalty compensating for pecuniary loss and should therefore be denied any priority under Section 507 of the Bankruptcy Code.

2. The bankruptcy court allowed the government's claim under Section 4971(a) of the Internal Revenue Code but denied that claim any priority under Section 507(a)(7)(E) of the Bankruptcy Code. The court recognized (Pet. App. 47a-48a) that, in *In re Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (1991), cert. denied, 502 U.S. 1092 (1992), the Sixth Circuit held that the excise tax imposed by Section 4971(a) must be given priority in bankruptcy. In *Mansfield Tire*, the court reasoned that, since Congress denominated Section 4971 as an excise tax and further expressly provided that claims for excise taxes have priority in bankruptcy under Section 507(a)(7)(E), the plain language of the statutes must be followed without regard to the underlying "purpose" served by the tax. 942 F.2d at 1059. The bankruptcy court, however, rejected the Sixth Circuit's ruling as "unnecessarily rigid" (Pet. App. 48a). The court stated that the fact that Congress denominated the tax imposed by Section 4971 as an excise tax should be disregarded in applying the Section 507(a)(7)(E) priority provision, for "blind acceptance of the label would defeat the purpose of the Bankruptcy Code" (Pet. App. 49a).

The court concluded that allowing a priority for the excise tax imposed under Section 4971(a) would be anomalous for several reasons. First, the court expressed concern that priority treatment of the excise tax claim would elevate that claim above the PBGC's claims for the underlying funding deficiency (Pet. App. 51a; see note 4, *supra*). Second, the court stated that, because bankruptcy courts may independently review state and local exactions to determine whether they represent a priority "tax" or a non-priority penalty, a failure similarly to review federal exactions would result in a "disparate treatment" that "the Bankruptcy Code does not contemplate" (Pet. App. 51a). Third, the court stated that payment of priority excise tax claims would burden respondents' efforts to reorganize, would diminish the return of other creditors and would give a "windfall" to the government (*ibid.*). Fourth, because the priority excise tax claims would be paid before the claims of the pensioners themselves, the court stated that the excise tax priority would harm the very parties that Section 4971 was intended to protect (Pet. App. 51a). For these reasons, the court concluded that it must be "empowered, under the circumstances of this case,

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Bankruptcy Code, 11 U.S.C. 503(b)(1)(B), 507(a)(1). The bankruptcy court concluded that most of the PBGC's claims were unsecured and had no priority in distribution of assets of the estates. The district court upheld those rulings but remanded on another issue; its order is therefore not yet final. See *PBGC v. Reorganized CF&I Fabricators of Utah, Inc.*, 179 B.R. 704 (D. Utah 1994).

to look behind the characterization of the exaction set forth in the statute and focus on the actual nature of the claims" (Pet. App. 52a).

The bankruptcy court applied what it termed the *Lorber Industries* "test" to determine the "actual nature" of the tax (Pet. App. 52a). That test derives from *County Sanitation District No. 2* v. *Lorber Industries of California, Inc.*, 675 F.2d 1062 (9th Cir. 1982), which was a bankruptcy case involving collection of a county sewer use fee. The Ninth Circuit held in that case that the following four elements characterize a "tax," as distinguished from a user fee, for purposes of determining entitlement to priority under the former Bankruptcy Act:

> (a) An involuntary pecuniary burden, regardless of name, laid upon individuals or property;
> (b) Imposed by, or under authority of the legislature;
> (c) For public purposes, including the purposes of defraying expenses of government or undertakings authorized by it;
> (d) Under the police or taxing power of the state.

675 F.2d at 1066. In the present case, the bankruptcy court concluded, under "its own independent application" of the *Lorber* standard, that the excise tax imposed under Section 4971(a) is not a "tax" but is in the nature of a penalty and is therefore not entitled to priority under Section 507(a)(7) of the Bankruptcy Code (Pet. App. 52a).

3. The United States appealed to the district court. While that appeal was pending, respondents issued a proposed plan of reorganization. The United States objected to the proposed plan because it failed

to make provision for payment of the Section 4971(a) excise tax in the event that the United States prevailed on its appeal of the priority issue. The bankruptcy court nonetheless confirmed the plan. The United States appealed from the order of confirmation.

In the meantime, respondents initiated an adversary proceeding in their bankruptcy case, seeking to subordinate the Section 4971(a) excise tax claims to the claims of general unsecured creditors. Respondents relied on Section 510(c) of the Bankruptcy Code, which authorizes bankruptcy courts to apply "principles of equitable subordination [to] subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim." 11 U.S.C. 510(c). Respondents contended that "principles of equitable subordination" permit the court to subordinate claims for "penalties" even if the holder of the claim has not engaged in any inequitable conduct. The bankruptcy court agreed with respondents and ordered the Section 4971(a) excise tax claim to be "subordinated to the claims of all other general unsecured creditors of the Debtors pursuant to 11 U.S.C. § 510(c)" (Pet. App. 21a). The United States appealed that order.

4. a. Twelve days after the bankruptcy court issued its original order denying priority to the Section 4971(a) tax, the Tenth Circuit issued its decision in *United States* v. *Dumler*, 983 F.2d 161 (1992). That case involved the bankruptcy priority of the government's claim for the 10 % "additional tax" imposed under Section 72(t) of the Internal Revenue Code upon early distributions from qualified retirement plans. The question in *Dumler* was whether that "additional tax" (26 U.S.C. 72(t)) is a "tax on or

measured by income" that is entitled to seventh priority in bankruptcy under 11 U.S.C. 507(a)(7)(A) (1988). The Tenth Circuit held in *Dumler* that, although Section 72(t) purports to impose a "tax," it in fact imposes a "penalty" for a nonpecuniary loss and therefore has no priority in bankruptcy.[5] 983 F.2d at 164-165. In reaching that conclusion, the Tenth Circuit stated that it rejected the reasoning of the Sixth Circuit in *Mansfield Tire* and held that it could "recharacterize for purposes of bankruptcy what Congress has deemed a tax in the Internal Revenue Code." 983 F.2d at 162, citing *In re Unified Control Systems, Inc.*, 586 F.2d 1036 (5th Cir. 1978).

b. In the present case, the district court consolidated the government's appeals from the orders of the bankruptcy court that (i) denied priority to the Section 4971(a) claim, (ii) confirmed the plan of reorganization, and (iii) subordinated the Section 4971(a) claim to the claims of all general unsecured creditors. The district court affirmed all three orders, reasoning that the Section 4971(a) excise tax "is a nonpecuniary loss penalty, not a tax" (Pet. App. 18a). The court stated that equitable subordination of the government's claim is appropriate "primarily" for the reasons set forth in the Tenth Circuit's opinion in the *Dumler* case (*ibid.*). But see note 5, *supra*.

5. The court of appeals affirmed (Pet. App. 1a-9a). Relying on its previous decision in *Dumler*, the court held that the name that Congress gives an exaction under the Internal Revenue Code does not determine

[5] The question whether the doctrine of equitable subordination would permit subordination of such a claim to all other general unsecured claims was not presented or addressed in *United States* v. *Dumler*.

its status in applying the priority provisions of Section 507(a)(7) of the Bankruptcy Code. The court stated that whether an exaction is a "tax" or a "penalty" for purposes of bankruptcy priority is to be determined by application of the four-part test of *Lorber Industries* (Pet. App. 6a). Under that test, the court concluded that the Section 4971(a) excise tax is in substance a "penalty," rather than a "tax," "for substantially the reasons given by the bankruptcy court" (Pet. App. 6a).

The court then addressed the equitable subordination of the government's claim. The court first noted that, "[b]ecause we have determined that the [claim of the United States in this case] is a nonpecuniary loss penalty not entitled to section 507 priority," the court had no reason to consider whether a claim that is entitled to priority under Section 507 may be subordinated to other claims under the "principles of equitable subordination" (Pet. App. 6a).[6] The court then acknowledged that equitable subordination historically has been imposed only when a creditor has engaged in wrongful conduct and that "the bankruptcy court expressly found that 'there [had] been no inequitable conduct on the part of the Internal Revenue Service'" in this case (Pet. App. 6a, 7a). The court stated, however, that in codifying the "principles of equitable subordination" in Section

[6] Whether a "case-by-case" balancing of the "equities" may be applied to subordinate a claim that the court believes to be "unfair" to other creditors even when Congress has expressly designated such a claim as a priority claim in Section 507 of the Bankruptcy Code—a question that the court of appeals asserted that it was not required to reach in this case—was addressed and answered affirmatively in *United States* v. *Noland*, No. 95-323. See note 2, *supra*.

510(c) of Bankruptcy Code, "Congress intended courts to continue developing" those principles (Pet. App. 7a). The court reasoned that the "developing" principles of equitable subordination permit a court (*id.* at 8a, quoting *In re Virtual Network Services Corp.*, 902 F.2d 1246, 1250 (7th Cir. 1990)):

> to equitably subordinate claims to other claims on a case-by-case basis without requiring in every instance inequitable conduct on the part of the creditor claiming parity among other unsecured general creditors.

In particular, the court held that these developing "principles of equitable subordination" do "not require a finding of claimant misconduct to subordinate nonpecuniary loss tax penalty claims" (Pet. App. 8a, citing, *e.g.*, *Burden* v. *United States*, 917 F.2d 115, 116-120 (3d Cir. 1990); *Schultz Broadway Inn* v. *United States*, 912 F.2d 230, 231-234 (8th Cir. 1990)).

Turning to "the equities in this case" (Pet. App. 8a), the court held that subordination is appropriate because the PBGC and other "general unsecured creditors of CF&I will receive only a small percentage of their claims" and "[d]eclining to subordinate the [excise tax claim of the United States] would harm innocent creditors rather than punish the debtor for failing to fund the pension plan" (*ibid.*).

INTRODUCTION AND SUMMARY OF ARGUMENT

1. This case presents two related questions concerning the proper application of the statutory priorities that Congress has established for the distribution of the assets of a debtor's estate. The first concerns whether the statutory "[s]eventh" priority for "an excise tax" in Section 507 of the

Bankruptcy Code (11 U.S.C. 507(a)(7)(E) (1988)) is available only when the underlying purpose of the "excise tax" is to raise revenue rather than to penalize or discourage undesirable conduct.

Section 4971(a) of the Internal Revenue Code imposes a 10% excise tax on a taxpayer's failure to meet the minimum funding requirements for its qualified pension plan (26 U.S.C. 4971(a)). The tax imposed by Section 4971(a) was expressly designated as an "excise tax" by Congress and therefore falls literally, and precisely, within the statutory priority for any "excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code.

The text and history of Section 507 both reflect that the priority that Congress granted to excise taxes is not conditioned on a finding that the tax is primarily designed to raise revenues. Excise taxes are routinely enacted by Congress to monitor and discourage particular types of conduct. Congress has not authorized courts to limit the statutory priority for such excise taxes to situations where the tax reimburses the government for some "actual pecuniary loss" (Pet. App. 52a). Excise taxes—like other taxes—are rarely designed to reimburse the government for a "pecuniary loss." If the statutory priority for "excise taxes" were available only when the government has incurred an "actual pecuniary loss," the priority would only rarely apply. Congress did not intend the unqualified, comprehensive priority that it provided for excise taxes in Section 507(a)(7)(E) to be given such an implausibly narrow scope.

2. The court of appeals not only concluded that the excise tax imposed by Section 4971(a) should be denied the statutory "[s]eventh" priority established for excise taxes under Section 507. The court further held

that the government's excise tax claim should be subordinated even to the claims of general unsecured creditors. The court based that holding on the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code, 11 U.S.C. 510(c).

The "principles of equitable subordination" that Congress codified in Section 510(c) authorize courts to subordinate an individual claim upon a showing that the creditor obtained its claim through misconduct or other inequitable behavior. The "principles of equitable subordination" do not permit a court categorically to prefer one type of innocent claimant over another. The categorical arrangement of the priorities afforded to different types of claims is a matter for Congress to decide, and a matter that Congress *has* decided. Equitable subordination operates in a field necessarily left unresolved by Congress—counteracting inequities resulting from the individual misconduct of creditors. That limited scope of the doctrine of equitable subordination was well-established when the "principles of equitable subordination" were codified in Section 510(c). The text of the statute and its legislative history confirm that Section 510(c) does not provide the courts with authority to disregard statutory priorities based upon a judicial conclusion that a *different* categorical priority scheme would result in a fairer or more equitable scheme of distribution.

In cases that arise under Chapter 11 of the Bankruptcy Code—such as the present case—"penalty" claims not involving pecuniary loss are within the same distributive category as general unsecured claims. If, as the court of appeals concluded, the Section 4971 excise tax claim involved in this case is

not entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code—on the theory that it is a "penalty" claim not involving pecuniary loss—the government's claim is then entitled to treatment on a parity with the general unsecured claims of other innocent creditors in this Chapter 11 case.

ARGUMENT

I

THE CLAIM OF THE UNITED STATES FOR AN EXCISE TAX OWED UNDER SECTION 4971(A) OF THE INTERNAL REVENUE CODE, 26 U.S.C. 4971(A), IS ENTITLED TO THE DISTRIBUTIVE PRIORITY FOR AN "EXCISE TAX" PROVIDED BY SECTION 507(A)(7)(E) OF THE BANKRUPTCY CODE, 11 U.S.C. 507(A)(7)(E) (1988)

Before entering bankruptcy, respondents incurred liability to the United States for an excise tax imposed under Section 4971(a) of the Internal Revenue Code, 26 U.S.C. 4971(a). Under Section 507(a)(7)(E) of the Bankruptcy Code, claims for excise taxes for which a return was due within three years of the petition for relief are granted "[s]eventh" priority in the distribution of the bankruptcy estate. See 11 U.S.C. 507(a)(7)(E)(i) (1988). See note 1, *supra*. The courts below denied priority to the government's excise tax claim in this case, however, on the ground that the excise tax under Section 4971(a) is intended to penalize the debtor rather than to raise revenue or compensate the government for "actual pecuniary loss" (Pet. App. 6a, 52a).

1. The court of appeals erred in holding that the excise tax imposed by Section 4971(a) is not entitled to the priority that Congress expressly provided to

every "excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code. Congress enacted Section 4971 of the Internal Revenue Code as part of the Employee Retirement Income Security Act of 1974 (ERISA). In connection with the qualified pension plan arrangements authorized by ERISA, Section 4971 was enacted to "impose[] an *excise tax* on the employer if he fails to fund the plan at the minimum required amounts." H.R. Rep. No. 807, 93d Cong., 2d Sess. 97 (1974) (emphasis added). Even before the Bankruptcy Code was enacted in 1978, Congress expressly designated the tax imposed by Section 4971 as an "excise tax" (*ibid.*; see also S. Rep. No. 383, 93d Cong., 1st Sess. 24, 33, 70 (1973)). Section 4971 was placed within Subtitle D of the Internal Revenue Code—which is entitled "Miscellaneous Excise Taxes"—precisely because Congress understood and intended that Section 4971 *is* an "excise tax" (H.R. Rep. No. 807, *supra*, at 97).[7]

When the Bankruptcy Code was enacted in 1978, one of the changes that it made to the provisions of the former Bankruptcy Act was the new, express specification of a "[s]eventh" priority for "excise tax" claims. Compare 11 U.S.C. 507(a)(7)(E) (1988) with 11

[7] Like other taxes—and unlike penalties—the Section 4971 excise tax is required to be reported on, and paid with, a return (IRS Form 5330). 26 C.F.R. 54.6011-1(a). The return for the tax at issue in the present case was due "after three years before the date of the filing of the petition [for relief in bankruptcy]" (11 U.S.C. 507(a)(7)(E)) and therefore comes directly within the terms of the excise tax priority in Section 507(a)(7)(E). See Pet. App. 41a (the "payment should have accompanied [respondent's] form 5330 annual report that the parties agree was due on September 15, 1990").

U.S.C. 104(a) (1976).[8] The joint floor statements that accompanied enactment of the Bankruptcy Code described the intended scope of this specific "excise tax" priority:

> All Federal, State, or local taxes *generally considered or expressly treated as excises* are covered by this category, including sales taxes, estate and gift taxes, gasoline and special fuel taxes, and wagering and truck taxes.

124 Cong. Rec. 32,416 (1978) (Rep. Edwards) (emphasis added); *id.* at 33,998, 34,016 (Sen. DeConcini) (same).[9]

Because Congress "expressly treated" the excise tax created under Section 4971 of the Internal Rev-

[8] Section 64a of the former Bankruptcy Act granted fourth priority to "taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy." 11 U.S.C. 104(a) (1976). In turn, Section 17a of the former Act provided that a discharge in bankruptcy would not release the bankrupt of liability for taxes that became due and owing within three years before bankruptcy, certain assessed and unassessed taxes for which the bankrupt failed to make a return, taxes the bankrupt attempted to evade or defeat or with respect to which the bankrupt made a fraudulent return, and taxes the bankrupt collected or withheld from others but failed to pay over. 11 U.S.C. 35(a) (1976).

[9] The House and Senate did not hold a formal conference in connection with the final enactment of the Bankruptcy Code (Act of Nov. 6, 1978, Pub. L. No. 95-598, 92 Stat. 2549, commonly known as the Bankruptcy Reform Act of 1978). The floor statements of the sponsors served in place of a conference committee report (see F. Kennedy, *Foreword: A Brief History of the Bankruptcy Reform Act*, 58 N.C.L. Rev. 667, 676-677 (1980)) and have been regarded as persuasive evidence of congressional intent. *Begier* v. *IRS*, 496 U.S. 53, 64 n.5. (1990).

enue Code as an "excise tax" even before the Bankruptcy Code was enacted, the Sixth Circuit correctly concluded in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059, that this tax is entitled to the "[s]eventh" priority established by Section 507(a)(7)(E). As this Court stated in *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), when the language of the Bankruptcy Code is plain, "the sole function of the courts is to enforce it according to its terms." *Id.* at 241, quoting *Caminetti* v. *United States*, 242 U.S. 470, 485 (1917). Moreover, as we have shown, while resort to the legislative history of these provisions is therefore unnecessary, that history leaves no room for any different conclusion.

2. The court of appeals erred in concluding (Pet. App. 5a) that an "excise tax" that exacts a "penalty" is not an "excise tax" within the meaning of Section 507(a)(7)(E) of the Bankruptcy Code. As the Sixth Circuit explained in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059, Congress expressly granted priority to any "excise tax" without adding any limitation based upon the "purpose" of the tax. Moreover, Congress clearly understood that an excise tax is no less an "excise tax" because it has a regulatory or deterrent purpose. Excise taxes in the Internal Revenue Code are often imposed on disfavored activities and are often designed to discourage or punish undesirable conduct. See, *e.g.*, 26 U.S.C. 4064 (gas guzzler tax), 4681 (Supp. V 1993) (tax on ozone-depleting chemicals), 4701 (tax on "registration-required" obligations not issued in registered form), 4911 (tax on excess lobbying by public charities), 4941 *et seq.* (tax on undistributed income and speculative investments of private foundations), 4955 (tax on political expenditures by Section

501(c)(3) organizations), 4981 and 4982 (taxes on undistributed income of real estate investment trusts and regulated investment companies), 4999 (tax on "golden parachute" payments), 5881 (tax on "greenmail"). If Congress had intended to exclude so many federal excise taxes from the excise tax priority, one would expect to find some indication to that effect in the Bankruptcy Code or in its legislative history. Instead, the legislative history specifies that the priority for excise taxes comprehensively includes "[a]ll [f]ederal, [s]tate or local taxes generally considered or expressly treated as excises" (124 Cong. Rec. 32,416 (1978) (Rep. Edwards) (listing the excise tax on "wagering" as one example)).

Related provisions of the Bankruptcy Code evidence that Congress intentionally omitted any distinction among excise taxes in enacting the priority for such taxes in Section 507(a)(7)(E). In Section 507(a)(7)(G), separate and apart from the "excise tax" priority of Section 507(a)(7)(E), Congress established an additional "[s]eventh" priority for tax-related "penalt[ies]" that are "in compensation for actual pecuniary loss" (11 U.S.C. 507(a)(7)(G)).[10] This Court

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[10] The courts below correctly noted (Pet. App. 4a, 52a) that a "penalty" that does not represent compensation for "pecuniary loss" does not fall within the priority for penalties that are "in compensation for actual pecuniary loss" under Section 507(a)(7)(G) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(G). The courts below erred, however, in reasoning (Pet. App. 5a, 52a) that, if the Section 4971(a) excise tax represents a "penalty" that does not compensate for pecuniary loss, it is *therefore* not entitled to priority under the Code. The fact that an excise tax might not qualify for one priority—under Section 507(a)(7)(G)—has no logical or appropriate bearing on whether

has noted that "it is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another" (*City of Chicago* v. *Environmental Defense Fund*, 114 S. Ct. 1588, 1593 (1994), quoted in *BFP* v. *Resolution Trust Corp.*, 114 S. Ct. 1757, 1761 (1994)). That presumption is especially appropriate when, as here, language conditioning an express priority is used in one paragraph and omitted in another paragraph of the same subsection of the statute. Thus, if Congress had intended to exclude from the priority that it established for "excise taxes" any excise tax that might be "punitive" rather than "compensatory" in nature, it surely knew how to do so—it had to look no further than Section 507(a)(7)(G) to find a model. Instead, Congress deliberately chose to include all of the numerous "excise taxes" that it has enacted over the years within the same "[s]eventh" priority, which encompasses all those taxes "generally considered or expressly treated as excises" (124 Cong. Rec. 32,416 (1978)). See also note 10, *supra*. That legislative determination of the priority to be afforded to "excise tax" claims in bankruptcy is, of course, binding on the courts. *United States* v. *Embassy Restaurant*, 359 U.S. 29, 31-32 (1959); *Nathanson* v. *Labor Board*, 344

such an excise tax is separately entitled to the *different* priority established by Congress for "excise taxes" in Section 507(a)(7)(E). Indeed, if an excise tax had to qualify for priority as a "penalty" compensating for "pecuniary loss" (under Section 507(a)(7)(G)), Congress would not have found it necessary to specify that "excise taxes" are entitled to priority under Section 507(a)(7)(E). In short, Congress specified that excise taxes need qualify for priority only under *one* provision of Section 507, not two.

U.S. 25, 28-29 (1952); *Carpenter* v. *Wabash Ry.*, 309 U.S. 23, 28 (1940).

3. The four-part *Lorber Industries* standard on which the court of appeals relied in concluding that a "penalty" is not an "excise tax" for purposes of Section 507(a)(7)(E) (see pages 6, 9, *supra*) has no proper application in this context. That test was formulated by the Ninth Circuit to determine whether an exaction that a State describes as a priority "tax" is instead a non-priority user fee. See 675 F.2d at 1066. Even if we assume that the *Lorber Industries* analysis is relevant in determining whether an exaction is a "tax" or a user fee for purposes of the general bankruptcy priority for a postpetition "tax" (11 U.S.C. 503(b)(1)(B), 507(a)(1)), it is not relevant in determining whether an exaction is a "penalty" or an "excise tax" within the specific priority established in Section 507(a)(7)(E).[11] The test described in

[11] In this case, in denying priority to the Section 4971(a) tax, the court of appeals relied (Pet. App. 5a) on its earlier decision in *United States* v. *Dumler*, 983 F.2d 161 (10th Cir. 1992). That case concerned whether the tax on premature distributions from qualified pension plans (26 U.S.C. 72(t)) was a "tax on or measured by income" for purposes of the priority established in Section 507(a)(7)(A) of the Bankruptcy Code. 983 F.2d at 163-164. The court of appeals did not attempt in this case to explain why the analysis of that decision should be applied in determining whether an exaction is an "excise tax" under the more specific provisions of Section 507(a)(7)(E) of the Code.

This Court's decisions in *City of New York* v. *Feiring*, 313 U.S. 283 (1941), and *New Jersey* v. *Anderson*, 203 U.S. 483 (1906), on which the court of appeals relied in *United States* v. *Dumler*, 983 F.2d at 163, involved whether state and local exactions constituted "taxes" for purposes of the priority for taxes under the former Bankruptcy Act (see note 8, *supra*). As the

Lorber Industries does not address whether a tax that is designed to discourage or monitor undesirable conduct is an "excise" or a "penalty."

As we have explained, however, an "excise tax" is often, if not ordinarily, designed to accomplish regulatory or deterrent objectives, as well as to raise revenue. See pages 16-17, *supra*. Moreover, Congress expressly designated the tax imposed under Section 4971 as an "excise tax." See pages 14-16, *supra*. The legislative history and the plain text of Section 507(a)(7)(E) reflect that the priority for an "excise tax" applies to all such exactions "generally considered *or* expressly treated as excises" (124 Cong. Rec. 32,416 (1978) (Rep. Edwards) (emphasis added)). The plain text, and the plain legislative command, of the Bankruptcy Code should not have been disregarded by the court of appeals. See, *e.g.*, *Patterson* v. *Shumate*, 504 U.S. 753, 757-759 (1992); *Connecticut National Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992); *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. at 242.

Sixth Circuit noted in *Mansfield Tire & Rubber Co.*, 942 F.2d at 1060, although it is appropriate carefully to review the designation of state and local exactions to insure that such claims are not improperly promoted within the federal priority scheme, courts are not free to recast an exaction that Congress has designated as a "tax" to be something else. In *A. Magnano Co.* v. *Hamilton*, 292 U.S. 40, 43 (1934), this Court stated that whether an exaction is for the public purpose of raising revenues turns on "the use which is to be made of the revenue derived from the tax, and not [on] any ulterior motive or purpose which may have influenced the legislature in passing the act." In any event, for the reasons we have explained, cases involving a general priority for "taxes" are not relevant in determining the scope of the more specific priority for "excise taxes" under Section 507(a)(7)(E).

II

IN THE ABSENCE OF INEQUITABLE CONDUCT BY THE GOVERNMENT, THE EXCISE TAX CLAIM OF THE UNITED STATES UNDER SECTION 4971(A) OF THE INTERNAL REVENUE CODE MAY NOT BE SUBORDINATED TO GENERAL UNSECURED CLAIMS UNDER THE "PRINCIPLES OF EQUITABLE SUBORDINATION" CODIFIED IN SECTION 510(C) OF THE BANKRUPTCY CODE

The court of appeals not only held that the claim of the United States under Section 4971(a) of the Internal Revenue Code should be denied the priority established for every "excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code. The court further concluded that the government's claim should be "equitably" subordinated even to the general unsecured claims of all other creditors (Pet. App. 6a-8a).[12]

The court recognized (Pet. App. 7a) that, "[i]n general, equitable subordination is imposed only when a creditor has committed some kind of wrongful conduct. *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1248 (7th Cir. 1990); *Benjamin* v. *Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 700 (5th Cir. 1977)." The court stated, however, that under the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code, 11 U.S.C. 510(c)(1), "a court

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[12] Because the court of appeals did not treat the excise tax claim as a claim entitled to priority under Section 507(a)(7)(E), the court expressly declined to consider whether "principles of equitable subordination" would permit the subordination of a priority claim asserted by an innocent creditor (Pet. App. 6a). That related question is the subject of *United States* v. *Noland*, No. 95-323, which is to be argued in tandem with this case. See note 2, *supra*.

may subordinate a nonpecuniary loss tax penalty claim without a showing of misconduct on the part of the government" (Pet. App. 7a). The court reasoned that "the equities in this case" favor subordinating the government's claim in order to avoid "harm [to] innocent creditors," such as "the PBGC, which will be paying the pension benefits due under [respondent's] terminated pension plan" (*id.* at 8a).

1. The expansive powers that the court has assumed under the doctrine of equitable subordination reflect a fundamental transformation and a serious misapplication of that doctrine. The judge-made doctrine of equitable subordination has a clear origin and a limited scope (*In re Columbia Ribbon Co.*, 117 F.2d 999, 1002 (3d Cir. 1941)):

> [A] court of bankruptcy under its equitable powers may disallow or subordinate a particular claim in bankruptcy which, because of the fraudulent nature of the claim or the bad faith or improper conduct of the claimant, ought not in equity and good conscience to be allowed or paid on a parity with other claims.

As we explain in detail in the brief filed concurrently in *United States* v. *Noland* (see note 2, *supra*), the doctrine of equitable subordination permits a court to subordinate a particular claim only if the claimant has acted inequitably in obtaining or enforcing its claim, to the detriment of other creditors. The issue that is to be resolved "under principles of equitable subordination" is whether (2 Collier Bankruptcy Manual ¶ 510.01[1], at 510-2 (3d ed. 1995)):

> harmful conduct [of the claimant] was directed at other creditors. If it was, the claim which is otherwise provable and allowable should be postponed until the claims of the creditors, who were harmed, have been satisfied.

See *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211, 229 (1948); *Pepper* v. *Litton*, 308 U.S. 295, 311 (1939); A. Herzog & J. Zweibel, *The Equitable Subordination of Claims in Bankruptcy*, 15 Vand. L. Rev. 83, 85 (1961).

The doctrine of equitable subordination does not, however, authorize a court to disregard categories of priorities specified by statute merely because the court concludes that a *different* ordering of priorities would yield a result that the court deems more appropriate or fair. By enacting a specific hierarchy of statutory priorities, Congress has itself measured the "equities" of the various classes of claims. *Carpenter* v. *Wabash Ry.*, 309 U.S. 23, 28 (1940). Claims that Congress has placed within the same class are to be treated on identical terms. Equitable subordination does not authorize a court to "reweigh" the equities that Congress itself has already adjusted.

As this Court has held, "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 206 (1988). In *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d 784, 787, cert. denied, 423 U.S. 913 (1975), the Ninth Circuit explained that:

> it is important to keep in mind that the chancellor never did, and does not now, exercise unrestricted power to contradict statutory or common law when he feels a fairer result may be obtained by application of a different rule. Courts of equity have long applied standards of conscience to conduct on an individual basis to prevent formally

> proper but unconscionable applications of legal rules; they have not engaged in the practice of making abstract legislative judgments about the fairness of a result contemplated by the legislature's statutory scheme if it has otherwise been followed in good faith and without overreaching.

Courts therefore traditionally and consistently held that "[d]ecisions about the treatment of *categories* of claims in bankruptcy proceedings * * * are not dictated or illuminated by principles of equity and do not fall within the judicial power of equitable subordination." *Burden* v. *United States*, 917 F.2d at 122 (Alito, J., concurring in part and dissenting in part; emphasis added). See also *Benjamin* v. *Diamond*, 563 F.2d 693, 700 (5th Cir. 1977) (equitable subordination requires that "[t]he claimant must have engaged in some type of inequitable conduct"); *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 788 ("there must be conduct either in acquiring or asserting the claim which is itself inequitable in order to subordinate a claim"); *In re Credit Industrial Corp.*, 366 F.2d 402, 408 (2d Cir. 1966). As the Eighth Circuit stated in *United States* v. *Killoren*, 119 F.2d 364, 366, cert. denied, 314 U.S. 640 (1941), in reversing a decision that had applied "equitable subordination" to a claim for taxes, "[t]he plain mandate of the law cannot be set aside because of considerations which may appeal to referee or judge as falling within general principles of equity jurisprudence."

2. a. In 1978, Congress codified the judge-made doctrine of equitable subordination as Section 510(c) of the Bankruptcy Code. That provision states that bankruptcy courts may, "under principles of equitable

subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim." 11 U.S.C. 510(c)(1). As we describe in detail in the brief filed concurrently in *United States* v. *Noland* (see note 2, *supra*), the text and history of this provision confirm that, in codifying the "principles of equitable subordination," Congress did not alter the established scope of that doctrine.[13] Because the "principles of equitable

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[13] The House Report on the provision enacted as Section 510(c) of the Bankruptcy Code indicates that Congress understood the doctrine of equitable subordination to be a narrow one. The Report states (i) that equitable subordination may be invoked only to deny equal treatment to creditors based on inequitable or unconscionable conduct in which they engaged or based on some special position which they occupied vis-a-vis the bankrupt that justified subordination of their claims and (ii) that the doctrine of equitable subordination is therefore inapplicable to the claims of innocent parties. H.R. Rep. No. 595, 95th Cong., 1st Sess. 196 (1977). See S. Rep. No. 989, 95th Cong., 2d Sess. 74 (1978):

> [A]ny subordination ordered under this provision must be based on principles of equitable subordination. These principles are defined by case law, and have generally indicated that a claim may normally be subordinated only if its holder is guilty of misconduct.

In addition to the decision in this case and in *United States* v. *Noland* (note 2, *supra*), other courts have recently held that the "principles of equitable subordination" codified in Section 510(c) are *not* confined to remedying creditor misconduct and instead permit courts categorically to subordinate "penalty" claims to the claims of other creditors who have incurred an "actual pecuniary loss" (Pet. App. 52a). See *Burden* v. *United States*, 917 F.2d 115, 119-120 (3d Cir. 1990); *United States* v. *Noland*, 48 F.3d 210 (6th Cir. 1995), cert. granted, No. 95-323 (Dec. 1, 1995); *In re Virtual Network Services Corp.*, 902 F.2d 1246, 1248-1250 (7th Cir. 1990); *Schultz Broadway Inn* v.

subordination" do not permit courts to restructure the categorical classifications of claims that Congress has made, or to subordinate *any* claim in the absence of inequitable conduct by a particular creditor, the court of appeals erred in subordinating the innocent claim of the government in this case. See Pet. App. 6a (noting that there was "no inequitable conduct on the part of the Internal Revenue Service").

b. Moreover, the court of appeals erred in this case in asserting that the lawful enforcement of "penalty" claims within the distributive classification that Congress established for such claims would effect an "inequitable" result. In reaching that conclusion, the court of appeals disregarded the decisions of this Court holding that penalties enacted by Congress are a "legitimate means to enforce" compliance with the law and must be given the priority in bankruptcy that Congress established for such claims. *Nicholas* v. *United States*, 384 U.S. 678, 694 (1966).[14]

United States, 912 F.2d 230, 232-234 (8th Cir. 1990). In so holding, these courts misinterpreted the legislative history of Section 510(c) and erred for the reasons explained in detail in the brief that we have filed concurrently in *United States* v. *Noland* (see note 2, *supra*).

[14] In *New Jersey* v. *Anderson*, 203 U.S. 483 (1906), the Court rejected the assertion that a statutory priority for state taxes should not be recognized because it created an "injustice" for other creditors and gave the State an undue "advantage" (*id.* at 490):

> [C]onsiderations of this character, however properly addressed to the legislative branch of the government, can have no place in influencing judicial determination. It is the province of the court to enforce, not to make the laws, and if the law works inequality the redress, if any, must be had from Congress.

In evaluating the "equities" of enforcing the Section 4971 excise tax, the court of appeals also erred in narrowly focusing on the effect of the tax on a single bankruptcy estate. The court acknowledged that this excise tax is designed to promote compliance with the minimum funding requirements of qualified pension plans (Pet. App. 6a, 47a). The ability of the excise tax to accomplish the "legitimate" legislative objective of ensuring wide compliance with pension funding requirements obviously depends upon the ability of the government to enforce that tax. The priority that Congress provided for excise taxes in 11 U.S.C. 507(a)(7)(E) is designed precisely to ensure the enforceability, and therefore the effectiveness, of such taxes.

The court of appeals ignored the structural role of the Section 4971(a) excise tax in concluding that it was "inequitable" for that tax to be given priority over the claim of "the PBGC, which will be paying the pension benefits due under [respondent's] terminated pension plan" (Pet. App. 8a). Even if the excise tax priority would be adverse to the interest of the PBGC in obtaining a distribution from a *particular* bankruptcy estate, the function of the excise tax (and of the priority afforded to it) is to make it ordinarily unnecessary for the PBGC to participate in bankruptcy cases by ensuring the full and timely funding of pension plans in *advance* of bankruptcy. See, *e.g.*, Staff of Senate Comm. on Finance, 100th Cong., 1st Sess., *Omnibus Budget Reconciliation Act of 1987, et al.* 180 (Comm. Print No. 100-63) (1987) (the excise tax "for failure to make contributions [is] needed to help ensure that contributions are made when due").

By focusing instead only on what the court perceived to be "fair" or "unfair" on the facts of the pre-

sent case, the court thus neglected to consider that, in adopting categorical priorities for the distribution of bankruptcy estates, Congress has itself measured the "equities" of the various classes of claims. *Carpenter* v. *Wabash Ry.*, 309 U.S. at 28. The court of appeals improperly relied on "principles of equitable subordination" to annul and supplant the legislative determination that Congress made of the proper priority to be afforded to the government's innocent assertion of its claim.

c. At the same time that the "principles of equitable subordination" were codified as Section 510(c) of the Bankruptcy Code, Congress expressly provided for the subordination of *pre*petition nonpecuniary loss penalties *only* in cases under Chapter 7 of the Code. 11 U.S.C. 103(b), 726(a)(4).[15] The text and history of these provisions reflect an explicit congressional determination *not* to subordinate prepetition nonpecuniary loss penalty claims in cases—such as the present case—that arise under Chapter 11 of the Bankruptcy Code.[16] In enacting the Bankruptcy

[15] The tax penalty involved in *United States* v. *Noland*, *supra*, is a *post*petition tax penalty for which Congress provided "[f]irst" priority in distribution in Chapter 7 cases. See 11 U.S.C. 503(b)(1)(B), 507(a)(1), 726(a)(1).

[16] The trustee is similarly allowed to avoid liens securing such penalties only in cases arising under Chapter 7. See 11 U.S.C. 724(a). The legislative reports emphasized the different treatment envisioned for penalties in cases under Chapter 7 and under Chapter 11:

> The lien is made voidable rather than void in chapter 7, in order to permit the lien to be revived if the case is converted to chapter 11, under which penalty liens are not voidable. To make the lien void would be to permit the filing of a chapter 7, the voiding of the lien, and the con-

Code, Congress considered and rejected a proposal to subordinate all "nonpecuniary loss" penalty claims under all chapters of the Code. *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. II, at 115, § 4-406(a)(3) (1973). Instead, Congress provided for the subordination of "nonpecuniary loss" penalties only in Chapter 7 cases. See 11 U.S.C. 726(a)(4). In Chapter 11 cases, such as the present case, Congress elected to place such penalties within the class of general unsecured claims.

By concluding that a prepetition nonpecuniary loss penalty should be subordinated to the claims of general unsecured creditors in Chapter 11 cases, the decision of the court of appeals thus contradicts the statutory treatment that Congress deliberately provided for such claims. Through misapplication of the "principles of equitable subordination," the court of appeals substituted its judgment about the relative worthiness of a category of claims for the different judgment that Congress made in enacting the Bankruptcy Code. As the Ninth Circuit stated in *Stebbins* v. *Crocker Citizens National Bank*, 516 F.2d at 788, the doctrine of equitable subordination does not permit a court to say, "in effect, * * * 'No, the distribution scheme provided by the [Bankruptcy] Act is a mistake.'"

The establishment of categorical priorities among competing, innocent claimants has never been the function of the judiciary in bankruptcy cases. In the Bankruptcy Code itself, Congress has specified in

> version to a chapter 11, simply to avoid a penalty lien, which should be valid in a reorganization case.

H.R. Rep. No. 595, *supra*, at 382; S. Rep. No. 989, *supra*, at 96.

detail the priorities that particular categories of innocent claimants are to receive. By ignoring these statutory priorities—and, indeed, adopting a precisely opposite set of priorities in this case—the decision of the court of appeals represents a marked departure both from the common understanding of "equitable" authority and from the specific understanding of the doctrine of "equitable subordination" that Congress codified in 1978 as Section 510(c) of the Bankruptcy Code. The court erred in substituting its own view of an "equitable" priority scheme for the statutory scheme that Congress itself established.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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JANUARY 1996

(1)

No. 95-325

In The

Supreme Court of the United States

October Term, 1995

UNITED STATES OF AMERICA,

Petitioner,

vs.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., *et al.*,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF FOR RESPONDENTS REORGANIZED CF&I FABRICATORS OF UTAH, INC., *et al.*

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QUESTIONS PRESENTED

1. Whether the Bankruptcy Code's priority for "an excise tax on a transaction occurring . . . [,]" 11 U.S.C. § 507(a)(7)(E)(i),[1] extends to a claim under 26 U.S.C. § 4971(a), labeled as a "tax" but imposed as a penalty for failing to make required pension plan contributions and not in compensation for any actual pecuniary loss to the Internal Revenue Service?

2. Whether a claim for a nonpecuniary loss penalty in a liquidating Chapter 11 case may be given a lower distributive priority than the claims of general unsecured creditors who suffered actual pecuniary losses, under (a) 11 U.S.C. §§ 510(c)(1) and 502(j) or (b) 11 U.S.C. §§ 1122(a), 1123(a)(1), 1123(a)(4), 1129(a)(7)(A) and 1129(b)(1)?

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[1] Under the Bankruptcy Reform Act of 1994, the priority for certain excise tax claims has been changed from 11 U.S.C. § 507(a)(7)(E) to 11 U.S.C. § 507(a)(8)(E). Pub. L. No. 103-394, § 304(c), 108 Stat. 4106, 4132 (Oct. 22, 1994). That amendment does not affect this case and, for consistency, this brief cites the excise tax priority as 11 U.S.C. § 507(a)(7)(E).

RULE 29.6 STATEMENT

On November 7, 1990, when Respondents filed bankruptcy, CF&I Steel Corporation was a publicly held company and owned all of the stock of its nine subsidiaries: CF&I Fabricators of Utah, Inc., Colorado & Utah Land Company, Kansas Metals Company, Albuquerque Metals Company, Pueblo Metals Company, Denver Metals Company, Pueblo Railroad Service Company, CF&I Fabricators of Colorado, Inc., and Colorado and Wyoming Railway Company.

On March 3, 1993, the effective date of the liquidating Chapter 11 plan, all interests of stockholders were canceled, including the interests of CF&I Steel Corporation as sole stockholder of each of the other corporate debtors. (Pet. 24a). Accordingly, Respondents are no longer "a corporation and nine subsidiaries." (IRS Br. 2). Respondents (some of whose names were amended to add "Reorganized") are ten separate corporate shells without shareholders and without elected officers or directors and are managed by a representative of creditors under governance provisions approved by the Bankruptcy Court. (Pet. 36a). That representative is Scott C. King. Respondents' correct names are: Reorganized CF&I Fabricators of Utah, Inc., Colorado & Utah Land Company, Kansas Metals Company, Albuquerque Metals Company, Reorganized Pueblo Metals Company, Denver Metals Company, Reorganized Pueblo Railroad Service Company, Reorganized CF&I Fabricators of Colorado, Inc., Reorganized CF&I Steel Corporation, and The Reorganized Colorado & Wyoming Railway Company.

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Statutes Cited:

No. 95-325

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1995

UNITED STATES OF AMERICA,
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v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., et al.,

RESPONDENTS.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENTS REORGANIZED CF&I FABRICATORS OF UTAH, INC., et al.

STATUTES INVOLVED

The relevant portions of 11 U.S.C. §§ 502(j), 507(a)(7)(E), 507(a)(7)(G), 510(c), 1122, 1123(a), 1129(a)(7) and 1129(b)(1), and 26 U.S.C. §§ 412 and 4971(a) are set forth in the appendix to the Respondents' Brief in Opposition to Certiorari. (Opp. 7a-14a).[2]

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[2] This brief will employ the following abbreviations in its citation of documents: "Pet." = Petition for Writ of Certiorari; "Opp." = Respondents' Brief in Opposition to Certiorari; "Pet. Rep." = Reply Brief for the United States on Certiorari; "IRS Br." = Brief for the United States; "PBGC Br." = Brief of the Pension Benefit Guaranty Corporation.

Pursuant to Rule 26.7 of the Rules of the Supreme Court and the Court's order dispensing with the requirement of a joint appendix in this case, citations to the record will be to the parties' appendices filed in the

(continued...)

STATEMENT OF THE CASE

Respondents (the "Reorganized Debtors") are ten bankrupt corporations liquidating their assets for the benefit of creditors pursuant to a confirmed plan of reorganization (the "Plan") under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"). (Pet. 22a-37a).[3] Proceeds of the liquidation have been and will be distributed to creditors under the direction of a representative of creditors. (*Id.*). The interests of former stockholders have been canceled and stockholders will receive nothing. (Opp. 3a-4a).

The Pension Plans. The Reorganized Debtors' predecessors, CF&I Steel Corporation ("CF&I") and its nine wholly-owned subsidiaries (all ten predecessor corporations are referred to as the "Debtors"), operated a steel plant in Pueblo, Colorado, and related businesses in Colorado, Utah, Kansas, and New Mexico. (CF&I R. 158-76). CF&I sponsored two qualified pension plans for the Debtors' employees and retirees (the "Pension Plans") (CF&I R. 6-8; IRS R. 32) and, as plan sponsor, was required by statute to meet minimum funding standards set by the Employee Retirement Income Security Act, 29 U.S.C. §§ 1001-1461 ("ERISA") and by the Internal Revenue Code, 26 U.S.C. §§ 1-9722. *See* 29 U.S.C. § 1082; 26 U.S.C. § 412(c)(11)(A). Annual minimum funding payments were due each September 15th for the preceding plan year. (Pet. 41a). Failure to meet this deadline would result in an "accumulated funding deficiency" in CF&I's plan accounts. 26 U.S.C. § 412(a).

[2](...continued)
court below, as follows: "IRS R." = Appellant's Appendix (item nos. 21, 15 and 15 on the Court of Appeals' docket nos. 94-4034, 94-4035 and 94-4036, respectively); "CF&I R." = Appellees' Appendix (item nos. 18, 21 and 21 on docket nos. 94-4034, 94-4035 and 94-4036, respectively).

[3] Chapter 11 of the Bankruptcy Code expressly authorizes liquidating plans. 11 U.S.C. § 1123(a)(5)(D).

Due to large losses in its steel business, CF&I could not pay its 1989 minimum funding payments totaling approximately $12.4 million, which came due on September 15, 1990. (CF&I R. 178). Both prior to and after filing under Chapter 11 on November 7, 1990 (the "Petition Date"), CF&I asked the Pension Benefit Guaranty Corporation (the "PBGC") to terminate the larger Pension Plan (the "Master Plan").[4] CF&I's request was denied until March 19, 1992, when the PBGC terminated the Master Plan. (CF&I R. 33-34).

Funding payments owed for retirees' pensions earned before the Petition Date were prepetition debts. Therefore, after the Petition Date, the Debtors by law could not correct the 1989 funding deficiencies or make any further pension funding payments except under a confirmed plan of reorganization. *PBGC v. LTV Corp.*, 875 F.2d 1008, 1019 (2d Cir. 1989), *rev'd on other grounds*, 496 U.S. 633 (1990); (CF&I R. 17-19; Pet. 51a). The Debtors continued to pay prepetition retiree health benefits after the Petition Date as required by 11 U.S.C. § 1114(e).

The PBGC's Claims. When a pension plan is terminated, the PBGC pays to retirees the guaranteed portion of the pension benefits which the PBGC funds out of insurance premiums paid by the plan sponsors and from assets collected from the terminated plan. (PBGC Br. 6). Guaranteed pension benefits are not paid from collection of taxes or out of general federal revenues. H.R. Rep. No. 1280, 93rd Cong., 2d Sess. 366 (1974) ("[T]he [guaranty] funds may draw upon the general funds of the Treasury

[4] The PBGC incorrectly states that CF&I did not take "any steps to terminate" the Pension Plans. (PBGC Br. 8). The Bankruptcy Court found to the contrary: "The Debtors attempted to persuade the PBGC into terminating the Master Plan both before and after filing the chapter 11 petitions." (Pet. 42a). Only the PBGC could unilaterally terminate the Pension Plans under 29 U.S.C. § 1342(c) because a collective bargaining agreement required maintenance of the Pension Plans by the Debtors. *See* 29 U.S.C. § 1341(a)(3); 11 U.S.C. § 1113(f).

only to the extent of their borrowing authority. The funds are to be self-sufficient and are not to be a charge on the Federal budget.").

The Bankruptcy Court initially allowed the PBGC's general unsecured claims for unfunded pension benefits in this case in an amount exceeding $220 million. *PBGC v. Reorganized CF&I Fabricators of Utah, Inc.* (*In re CF&I Fabricators of Utah, Inc.*), 179 B.R. 704, 706 (D. Utah 1994). On November 27, 1995, the Bankruptcy Court reduced the PBGC's general unsecured claims to approximately $122.5 million. *In re CF&I Fabricators of Utah, Inc.*, 19 Employee Benefits Cas. 2371 (BNA) (Bankr. D. Utah 1995). The PBGC has appealed that order. Except for approximately $2 million paid as priority claims, the PBGC's claims were treated as general unsecured claims in the Plan. (CF&I R. 9, 24, 189-90; IRS R. 33). These claims *included* all unpaid minimum funding contributions for the Pension Plans. (CF&I R. 10, 138, 220-39). Payments on the PBGC's claims will in part reimburse the PBGC and in part go to retirees to pay retirement benefits not covered by the PBGC's guaranty limits. Under a statutory allocation formula, the PBGC, as successor trustee of the Master Plan (Pet. 42a), has a statutory duty to grant a share of its own recovery for retirees' nonguaranteed benefits. 29 U.S.C. § 1322(c).

The IRS' Claims. As part of ERISA, Congress added 26 U.S.C. § 4971 ("Section 4971") to the Internal Revenue Code to discourage and penalize pension plan underfunding. H.R. Rep. No. 807, 93rd Cong., 2d Sess. 28 (1974); S. Rep. No. 383, 93rd Cong., 1st Sess. 24-25 (1973). Section 4971 imposes two tiers of exactions on the plan sponsor based on a percentage of the total accumulated funding deficiency of the pension plan: a 10% "tax" under Section 4971(a) (first tier "tax") and a 100% "tax" under Section 4971(b) (second tier "tax"). The 10% first tier "tax" is imposed immediately upon the employer's failure to remit the minimum funding payment by the deadline. 26 U.S.C. § 4971(a). Thereafter, if the sponsoring employer does not "correct" the

deficiency, the 100% second tier "tax" is imposed. 26 U.S.C. § 4971(b).

The Section 4971 "taxes" totaling 110% are imposed as penalties *in addition to* liability for the underlying minimum funding payment which may be collected from the employer by the PBGC. S. Rep. No. 383, 93rd Cong., 1st Sess. 24-25 (1973). If the Section 4971 "taxes" are paid to the IRS, they become general revenues in the United States Treasury and do not reimburse any loss of the PBGC, the pension plans, or the retirees. 26 U.S.C. § 7809.

The IRS' tactic of accumulating 10% and 100% claims in this case confirms that the claims were penalties. The IRS initially filed the following claims against the Debtors for amounts allegedly owing under (i) Section 4971(a) for CF&I's failure to make the 1989 minimum funding payment of $12,416,638 and (ii) Section 4971(b) for the Debtors' failure to make postpetition payments during their bankruptcy to correct the accumulated funding deficiency for 1989 (CF&I R. 3-4; IRS R. 26-27, 34-37):

Pension Plan	10% "Tax"	100% "Tax"
Noncontributory	$ 36,577	$ 365,766
Master	$1,205,047	$12,050,472
Total	$1,241,624	$12,416,238

The IRS asserted priority under 11 U.S.C. § 507(a)(7)(E) (excise taxes) and 11 U.S.C. § 507(a)(7)(G) (pecuniary loss penalties) (now codified at 11 U.S.C. § 507(a)(8)(G)).

The Pension Plans' minimum funding payments for 1990, in the amount of approximately $13,207,897, were due September 15, 1991, nearly a year after the Petition Date. (IRS R. 26-27, 35-37). Because these payments to the Pension Plans were prepetition obligations, CF&I was prohibited from making them. (Pet. 51a). Nevertheless, according to the IRS, the combined accumulated funding deficiency for 1989 and 1990 was $25,624,135, *i.e.*, $12,416,238 for 1989 *plus* $13,207,897 for 1990. (IRS R. 26-27, 35-37). Amounts assessed under Section

4971 are cumulative; "taxes" for 1990 are calculated on the *combined* underfunding for 1989 and 1990. 26 U.S.C. §§ 412(a), 4971(c).

The IRS amended its proofs of claim to include both Section 4971(a) and Section 4971(b) "taxes" of $2,562,413 and $25,624,135, respectively. Therefore, this additional claim was for approximately a 220% "tax" for failure to make the 1990 payment. The claim for 1990 when added to the claim for 1989 "taxes" totaled $41,844,410. (IRS R. 26-29). The "tax" for the 1991 payment would be 330% and so on. In the Bankruptcy Court, the IRS argued alternatively that the Section 4971 claims were entitled to priority as secured claims, excise tax claims and pecuniary loss penalties and, furthermore, that all of its claims except for a prepetition 10% penalty for 1989 were postpetition "administrative taxes" with first priority under Sections 503(b)(1)(B)(i) and 507(a)(1) of the Bankruptcy Code. (Pet. 43a-45a).

Debtors' Objections to the IRS' Claims. The Debtors filed a claim objection requesting that the Bankruptcy Court determine that, although Section 4971 may be a "tax" for purposes of collection and enforcement under the Internal Revenue Code, any allowed claims were, for purposes of priority under the Bankruptcy Code, nonpecuniary loss penalties not entitled to tax priority. (IRS R. 1-13). Simultaneously, the Debtors filed an adversary complaint requesting that the Bankruptcy Court subordinate the Section 4971 claims to the claims of general unsecured creditors who suffered actual pecuniary losses. (IRS R. 14-24). The IRS relied solely on the word "tax" contained in Section 4971 and the subtitle heading "Miscellaneous Excise Taxes" under which Section 4971 is codified as being conclusive of entitlement to priority as an "excise tax on a transaction" under the Bankruptcy Code. The lower courts found that the IRS' claims were not for any pecuniary loss (Pet. 6a, 18a, 47a, 52a, 62a; Opp. 3a) and the IRS has not questioned that finding of fact. (CF&I R. 45-56; Pet. 14a, 47a).

The Bankruptcy Court denied the priorities claimed by the IRS and disallowed postpetition portions of the claims in a Memorandum Decision and Order dated November 25, 1992, published as *In re CF&I Fabricators of Utah, Inc.*, 148 B.R. 332 (Bankr. D. Utah 1992). (Pet. 38a-62a). The Bankruptcy Court ruled that, although the IRS asserted its claims as "excise taxes," these claims were nonpecuniary loss penalties for purposes of priority in bankruptcy. (Pet. 61a-62a).[5]

The Plan of Reorganization. Under the Plan, all assets of the Debtors have been or will be sold and the proceeds, less costs of administration, will be distributed to creditors. Recovery for general unsecured claims is estimated at less than ten cents on the dollar. (CF&I R. 134-41, 202-18, 537). No property will revest in the Reorganized Debtors. After Plan consummation, the Reorganized Debtors will be empty corporate shells with no assets and no stockholders. (CF&I R. 148).

The Plan, under agreements negotiated with the PBGC and other creditors, established Classes 11, 12, 13 and 14 for general unsecured creditors. (CF&I R. 95-101, 137-41, 196-200). Class 11 is an administrative convenience class of the type authorized by 11 U.S.C. § 1122(b). (CF&I R. 95-96, 137, 196-97). Class 12 includes all nonpriority general unsecured claims (including the PBGC's unsecured claims) not included in Classes 11, 13 and 14. (CF&I R. 96-101, 137-41, 197-200). All allowed claims in Class 11 and Class 12 are claims for actual pecuniary losses. (CF&I R. 129, 137-41).

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[5] The Bankruptcy Court did not state that Section 4971's tax label should be "disregarded." (IRS Br. 5). The Court stated that the label was "not controlling." (Pet. 49a). The Court disallowed all postpetition claims under Section 4971 because the Bankruptcy Code prohibited the Debtors from paying the minimum funding payments. (Pet. 53a-54a, 62a).

Class 13 includes the IRS' claims under Section 4971 and all other claims for nonpecuniary loss penalties. (CF&I R. 101, 141, 200). Class 14 includes all general unsecured claims of the Debtors against each another. (*Id.*). Since holders of general unsecured claims in Class 12 will not be paid in full, there will be no distributions under the Plan to holders of claims subordinated in Classes 13 and 14. (CF&I R. 101, 141, 208-18). Any priority payment to the IRS for its Section 4971 claims would reduce, dollar for dollar, distributions to holders of general unsecured claims who suffered pecuniary losses. (Opp. 4a).[6]

The Debtors' Plan, which expressly subordinated the IRS' Section 4971 claims in Class 13, was overwhelmingly approved by creditors. (CF&I R. 260-269). Although the PBGC now joins the IRS in its arguments, the PBGC filed ten ballots accepting the Plan and filed a written statement in support of the Plan. (CF&I R. 139-140, 266).

Confirmation of the Plan. At the January 27, 1993 confirmation hearing, the Debtors presented uncontroverted evidence that the Plan was proposed in good faith and in compliance with the Bankruptcy Code (CF&I R. 304, 313), that creditors would receive under the Plan at least as much as they would receive if the Debtors were liquidated under Chapter 7 (CF&I R. 305, 315-16), that the Debtors had not achieved profitable operations in bankruptcy (CF&I R. 311), that a "stand-alone" plan under which the Debtors would continue to operate was not viable (CF&I R. 311-12), that the sale of major steel making assets to an affiliate of Oregon Steel Mills, Inc. was the most viable alternative for reorganization (*id.*), that the sale of

[6] The Plan of Reorganization also provided for the full funding and standard termination of the smaller Pension Plan (the "Noncontributory Plan"). (CF&I R. 143, 577-78). Under provisions of the Plan of Reorganization not appealed by the IRS, all claims relating to the Noncontributory Plan, including the IRS' claims of some $36,577 (Pet. 44a), are deemed satisfied and are no longer at issue. (CF&I R. 143).

major assets was proposed in good faith and for a fair price (CF&I R. 311-12, 341-42), and that if penalty claims or prebankruptcy intercompany claims were allowed to participate with general unsecured claims on a pro-rata basis, distributions to general unsecured creditors would be reduced (CF&I R. 325-26).

The Debtors were deeply insolvent. (Opp. 3a-4a; CF&I R. 208-218). The Section 4971 claims exceeded estimated distributions to all general unsecured creditors. (CF&I R. 206). The Bankruptcy Court found that allowing the IRS the same distributive priority as the PBGC and other general unsecured creditors would advance neither the legislative purpose of Section 4971 nor the principle of equality of distribution that underlies the Bankruptcy Code. *See Begier v. IRS*, 496 U.S. 53, 58 (1990) ("Equality of distribution among creditors is a central policy of the Bankruptcy Code."). Instead it would punish creditors. (Pet. 50a-51a).

The Bankruptcy Court also found that the IRS' claims, if given priority, would have defeated any attempt by the Debtors to reorganize. (Pet. 51a). Among the interests dependent upon a successful reorganization (in this case, through the sale of assets to another steel manufacturer under the Plan) were the jobs of approximately 1,500 employees (CF&I R. 163) and the medical benefits of approximately 5,164 retirees and 3,489 dependents of retirees (CF&I R. 193).

On February 12, 1993, the Bankruptcy Court entered its order confirming the Plan. (Pet. 22a-37a). The Bankruptcy Court made all findings and conclusions required by law for confirmation of the Plan, including that the Plan complied with all applicable provisions of the Bankruptcy Code, and specifically those respecting classification of claims and contents of the Plan (Pet. 27a), that the Plan was proposed in good faith and not by any means forbidden by law (*id.*), and that as to impaired classes of claims that did not accept the Plan (such as Class 13 that included the IRS' penalty claims) the Plan did not discriminate unfairly and was fair and equitable (Pet. 28a). Although the

Bankruptcy Court sustained some of the IRS' objections to the Plan by requiring modifications of the Plan that included extinguishing CF&I's stock in its subsidiaries, the IRS' objections based on the tax priority of its Section 4971 claims were overruled. (Pet. 23a-24a).

The Bankruptcy Court's Ruling on Subordination of the IRS' Claims. By order dated March 10, 1993, the Bankruptcy Court granted the Debtors' summary judgment motion (filed prior to confirmation) to subordinate pursuant to Section 510(c) of the Bankruptcy Code all of the IRS' nonpecuniary loss penalty claims under Section 4971, to the extent not disallowed (*see supra* note 5), to the claims of general unsecured creditors who suffered pecuniary losses. (Pet. 19a-21a). The IRS has not disputed any of the detailed factual findings of the Bankruptcy Court which are set forth in full in the appendix to the Reorganized Debtors' Brief in Opposition to Certiorari (Opp. 1a-6a), including the Court's finding that the Debtors had a multitude of financial problems and did not file bankruptcy solely to deal with the IRS' claims or to avoid payment of tax penalties (Opp. 3a-5a). Consequently, the IRS' claims were subordinated under both the Plan and under Section 510(c).[7]

[7] The Bankruptcy Court ruled on subordination in conjunction with confirmation of the Plan, which is one of the three orders on appeal here. (Opp. 3a). The IRS did not object to the Plan's classification or treatment of nonpecuniary loss penalty claims in Class 13 and has never challenged the Bankruptcy Court's findings that the Plan complied with the Bankruptcy Code's requirements respecting classification and treatment of such claims. (Pet. 27a-28a). The IRS only objected to being included in Class 13 by arguing its claims were taxes, not penalties. Because the IRS did not object to Class 13, the Bankruptcy Court approved the classification without addressing arguments on classification. If the Bankruptcy Court's order regarding priority is upheld, the IRS has not preserved any objection as to its treatment under the Plan.

The IRS sought, but was denied, a stay pending appeal. (Pet. 14a). On November 23, 1993, in a consolidated appeal, the District Court affirmed the Bankruptcy Court's orders on priority, confirmation and subordination. (Pet. 10a-11a). The Court of Appeals for the Tenth Circuit affirmed the District Court's decision. (Pet. 1a-9a). The Court of Appeals concluded that "the bankruptcy court correctly refused to treat the [Internal Revenue Code's] label as determinative for priority in bankruptcy." (Pet. 6a). With regard to subordination of the Section 4971 claims, the Court of Appeals followed the majority of courts in holding that 11 U.S.C. § 510(c) "does not require a finding of claimant misconduct to subordinate nonpecuniary loss tax penalty claims." (Pet. 8a).[8]

In a separate proceeding in these bankruptcy cases, the District Court found that the Plan had been substantially consummated and that challenges to the confirmation order were moot, at least insofar as they seek to upset sales transactions and property transfers that have taken place in reliance on the confirmation order. *United Mine Workers of Am. Combined Fund v. CF&I Fabricators of Utah, Inc. (In re CF&I Fabricators of Utah, Inc.)*, 169 B.R. 984, 993-94 (D. Utah 1994). Even though the IRS has appealed the confirmation order, the IRS would have full relief as to its Section 4971 claim (i.e., priority as an excise tax or a general unsecured claim) if any relief granted by the Court were limited to the matters of priority argued by the IRS. The Plan as confirmed provides for full payment of allowed priority tax claims and provides that if nonpriority penalty claims are not subordinated they will be included with other general unsecured creditors. (CF&I R. 134, 141). The IRS has not argued that the entire Plan should or could be undone.

[8] The IRS substitutes the words "excise tax claim of the United States" in place of "IRS's penalty claim" in its quotation of the Court of Appeals' opinion. (IRS Br. 10; Pet. 8a). This distinction is critical to the Court of Appeals' reasoning.

INTRODUCTION AND SUMMARY OF ARGUMENT

1. In the Bankruptcy and District Courts, the IRS claimed that the Debtors' failure to pay $25.6 million to the Pension Plans rendered their estates liable for $41.8 million in 10% and 100% "excise taxes" under Section 4971. Even though the IRS could offer no evidence of monetary loss, the IRS insisted that its $41.8 million claims be paid on a priority basis that would have eliminated any recovery for the PBGC, the retirees, the Noncontributory Plan, and all other general unsecured creditors, thereby destroying the Debtors' reorganization. Faced with the unsavory prospect of arguing that result to the Court of Appeals, the IRS narrowed its appeal, changing the amount, but not the substance, of its claims.

a. The IRS asserts that its Section 4971 claims are entitled to priority under 11 U.S.C. § 507(a)(7)(E) ("Section 507(a)(7)(E)") as an "excise tax on . . . a transaction occurring before the filing of the petition." The IRS bases its claim to priority on the superficial argument that because Section 4971 uses the word "tax" and appears in the Internal Revenue Code under the subtitle heading "Miscellaneous Excise Taxes," claims under this section must conclusively be considered "excise taxes" under Section 507(a)(7)(E). The Court has held that similar words used in different federal statutes should not be presumed to have the same meanings. Nevertheless, the IRS mistakenly presumes that the words "tax" and "excise tax" must have identical meanings in Section 4971 and Section 507(a)(7)(E) despite the different purposes of these two statutes and Section 4971's admittedly noncompensatory and punitive nature. The language of the Bankruptcy Code and the Court's cases demonstrate that Internal Revenue Code labels do not control priorities in bankruptcy.

b. The IRS' claims do not meet the two statutory prerequisites for priority under Section 507(a)(7)(E) because its claims are neither "taxes" for purposes of the Bankruptcy Code nor did the claims arise from "a transaction occurring" before the Petition Date. Decisions of the Court have given the term "tax"

an established meaning under bankruptcy law. There is no evidence that the Bankruptcy Code modified that established meaning. The IRS has acknowledged that if this traditional meaning is applied in this case, its claims are not entitled to tax priority because the purpose of Section 4971 is not to raise revenue for the government but rather to punish pension plan sponsors for a violation of ERISA. "Excise tax" claims similar to the IRS' Section 4971 claims were held not to have tax priority under the Bankruptcy Act and there is no evidence that the Bankruptcy Code elevated nonpecuniary loss penalties to a new priority status. Section 507(a)(7)(G) denies priority to prepetition nonpecuniary loss penalties.

c. The IRS incorrectly asserts, based solely on the phrasing of legislative materials, that Section 507(a)(7)(E) grants "unqualified comprehensive" priority to "any" and "every" excise tax. (IRS Br. 4, 11, 14, 21). The actual language of the statute grants priority to unsecured claims of governmental units "only to the extent that such claims are for . . . an excise tax on (i) a transaction occurring [within the specified period]." 11 U.S.C. § 507(a)(7)(E). The Section 4971 claims are not based on a "transaction" having occurred, but instead are imposed upon the nonoccurrence of a pension funding payment.

2. The Bankruptcy Court properly found that under the "facts presented in this case" the IRS' nonpecuniary loss claims properly should be subordinated to the claims of creditors who suffered pecuniary losses. (Opp. 5a). The Bankruptcy Court did not subordinate the IRS' penalty claims based on vague perceptions of fairness as the IRS suggests (IRS Br. 27) or on "subjective notions," "hostility," or popularity as the PBGC suggests (PBGC Br. 20), but rather subordinated the claims based on detailed factual findings made in the context of a carefully negotiated plan overwhelmingly approved by creditors, including the PBGC.

a. The Plan was required by law to place the Section 4971 claims in a separate, subordinated class. Section 1129(a)(7) of the

Bankruptcy Code required that nonconsenting impaired creditors must receive as much under the Plan as in a Chapter 7 liquidation. Because prepetition nonpecuniary loss penalty claims are expressly subordinated in Chapter 7, Section 1129(a)(7) could only be met by separately classifying the Section 4971 claims under 11 U.S.C. § 1122 and subordinating that class to general unsecured claims under the Plan. Unlike priority claims, no "distributive category" (IRS Br. 12) exists for general unsecured claims under the Bankruptcy Code.

b. The lower courts correctly held that Section 510(c) of the Bankruptcy Code does not require a finding of inequitable conduct, either in its language, its history or its purpose. Subordinating nonpecuniary loss tax penalties under "principles of equitable subordination" is consistent with the Court's decisions regarding the purpose of equitable subordination and with all of the decisions of Courts of Appeals which have addressed this issue. The Bankruptcy Court's findings that the IRS' claims would punish and be paid principally by the very creditors (the PBGC and retirees) intended to be protected by pension funding requirements fully supported subordination of these claims.

ARGUMENT

I. SECTION 4971 CLAIMS ARE NOT ENTITLED TO PRIORITY AS "EXCISE TAXES" ON "TRANSACTIONS."

A. The Bankruptcy Code Does Not Define "Excise Tax" by Reference to the Internal Revenue Code.

The IRS' purported "plain meaning" argument is not founded on the plain language of the Bankruptcy Code. Instead, the IRS uses nonbankruptcy statutes and legislative materials to interpret Section 507(a)(7)(E). The IRS cites no authority for its basic assumption that the words "tax" and "excise tax" in the Internal Revenue Code must have the identical meanings as the words "tax" and "excise tax" in Section 507(a)(7)(E). The IRS errs in first assuming that "excise tax" will have an identical meaning in

both statutes and, based on that faulty assumption, in concluding that the language "is plain" and that its claim falls "literally and precisely" within Section 507(a)(7)(E).

When definitions from the Internal Revenue Code are to apply in bankruptcy, the Bankruptcy Code specifically cites to such statutes. *See, e.g.*, 11 U.S.C. § 101(41)(C)(i) ("governmental plan, as defined in section 414(d) of the Internal Revenue Code"); 11 U.S.C. § 101(41)(C)(ii) ("eligible deferred compensation plan, as defined in section 457(b) of the Internal Revenue Code"); 11 U.S.C. § 346(g)(1)(c) (gains or losses on transfers of estate property in Chapter 11 cases to a debtor's affiliates are recognized "to the same extent that such transfer results in the recognition of gain or loss under section 371 of the Internal Revenue Code").[9] Similarly, where the Bankruptcy Code grants priority to a class of claims arising under another federal statute, it also does so expressly. *See, e.g.*, 11 U.S.C. § 503(b)(6) (administrative

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[9] Additional examples in the Bankruptcy Code of an express application of definitions, terms or provisions from other federal statutes include: § 101(21B)(A) ("insured depository institution"); § 101(33)(B) ("institution-affiliated party"); § 101(39) ("mask work"); § 101(48) ("exempted securities"); § 109(b) ("insured bank"); § 345(b)(2) ("securities"); § 362(b)(12) (an action under the Ship Mortgage Act); § 362(b)(16) ("guaranty agency"); § 363(b) (the Clayton Act); § 365(d)(6)(C) ("aircraft"); § 522(d)(10)(E)(iii) (the Internal Revenue Code); § 523(a)(13) (title 18, United States Code); § 523(a)(2)(C) ("an extension of consumer credit"); § 525(a) (Perishable Agricultural Commodities Act and the Packers and Stockyards Act); § 525(c)(2) ("student loan program"); § 541(b)(3) (Higher Education Act of 1965); § 555 (Securities Investor Protection Act of 1970); § 724(d) (Internal Revenue Code); § 761(5), (6), (7), (8) ("commodity option," "contract market," "contract of sale," "commodity," "future delivery," "board of trade," and "futures commission merchant"); § 1110(a)(2)(A) ("aircraft"); § 1110(a)(2)(B) ("documented vessel"); § 1145(b) ("underwriter"); § 1166 (Regional Rail Reorganizational Act of 1973); and § 1167 (Railway Labor Act).

expense priority includes "the fees and mileage payable under chapter 119 of title 28"); 11 U.S.C. § 507(a)(1) (first priority granted to "any fees and charges assessed against the estate under chapter 123 of title 28").

The IRS concedes that labels do not control state claims (IRS Br. 19-20 n.11) but insists on a different rule for federal claims. Where Congress wanted to make such a distinction, it did so clearly and unequivocally, as in Section 346(a) of the Bankruptcy Code, which provides:

> Except to the extent otherwise provided in this section, subsections (b), (c), (d), (e), (g), (h), (i), and (j) of this section apply *notwithstanding any State or local law imposing a tax, but subject to the Internal Revenue Code of 1986.*

11 U.S.C. § 346(a) (emphasis added).

If Congress had intended Internal Revenue Code meanings to control tax priorities under Section 507(a)(7)(E) or to grant wholesale "excise tax" priority to all claims assessed against a debtor under Subtitle D of Title 26, an express reference would have been made. Instead, Congress chose not to define the terms "tax" and "penalty" in the Bankruptcy Code, either directly or by reference to another statute. Consequently, these terms should be given their commonly understood meanings for bankruptcy purposes. *Field v. Mans*, 116 S. Ct. 437, 443 (1995) ("'[U]nless the statute otherwise dictates, . . . Congress means to incorporate the established meaning of these terms.'") (*quoting NLRB v. Amax Coal Co.*, 453 U.S. 322, 329 (1981)).

B. The Section 4971 Claims Are Not Taxes for Purposes of the Bankruptcy Code.

The Bankruptcy Act of 1898, 11 U.S.C. §§ 1-1103 (repealed 1978), granted priority to "taxes" but did not define this term. Consequently, the courts developed a definition of "taxes" in bankruptcy that has been applied for nearly a century, with remarkably little change over that period. In 1906, the Court

reviewed a state corporation franchise tax to determine its tax priority under Section 64a of the Bankruptcy Act (11 U.S.C. § 104a (repealed 1978)). *New Jersey v. Anderson*, 203 U.S. 483, 492 (1906). The Court stated, "Generally speaking, a tax is a pecuniary burden laid upon individuals or property for the purpose of supporting the government." *Id.* The Court held that the state's claim had all of the characteristics of a tax and was entitled to tax priority. *Id.*

The Court has since applied a similar analysis to both state and federal exactions. *See United States v. Childs*, 266 U.S. 304, 309-10 (1924) ("interest" on federal taxes distinguished from a "penalty"); *New York v. Jersawit*, 263 U.S. 493, 496 (1924) (statutory "interest" on a state claim treated as a "penalty" for bankruptcy purposes). In *City of New York v. Feiring*, 313 U.S. 283 (1941), the Court restated the principle that true "taxes" for purposes of bankruptcy law are defined as "pecuniary burdens laid upon individuals or their property, regardless of their consent, for the purpose of defraying the expenses of government or of undertakings authorized by it." *Id.* at 285, 287 (*citing New Jersey v. Anderson*, *supra*, and *United States v. Updike*, 281 U.S. 489, 494 (1930) (a federal claim under the Internal Revenue Act of 1926 was a "tax")). The *Feiring* Court ruled that a New York City sales tax met this definition and consequently was entitled to tax priority under the Bankruptcy Act. *Id.* at 288.

The *Feiring* definition of a "tax" was developed by the Court precisely for differentiating between true taxes and other types of federal and state claims (however denominated) for purposes of bankruptcy priority. However, this definition was simply a summary of the already well established understanding of a "tax" for various purposes. Therefore, the IRS' attempt to distinguish *Feiring* as involving a state, as opposed to a federal, statute misses the point. Similar reasoning had long been applied to federal statutes. The *Feiring* decision simply became a commonly cited definition in an extensive line of cases regarding both state and federal claims in bankruptcy. *See Texas Am. Oil Corp. v. United*

States Dep't of Energy, 44 F.3d 1557, 1571 (Fed. Cir. 1995) (*en banc*) ("restitution" in Petroleum Overcharge and Distribution Act was partially a penalty for bankruptcy purposes); *United States v. River Coal Co.*, 748 F.2d 1103, 1106 (6th Cir. 1984) (a federal "reclamation fee" was a tax for bankruptcy purposes). Even the PBGC agrees that the *Feiring* rationale applies to at least some federal statutory claims, as it must in order to argue that unfunded pension benefit liabilities under ERISA are "taxes" for bankruptcy purposes. (PBGC Br. 18-19).

After the *Feiring* decision, the Court, in analyzing a *federal* excise tax for bankruptcy purposes, held, "We think that our decision in the *Feiring* case is controlling here." *United States v. New York*, 315 U.S. 510, 515 (1942). In *New York*, the Court examined whether an amount labeled as a "tax" under the Social Security Act was a "tax" for purposes of bankruptcy. *Id.* at 513-16.[10] Applying the *Feiring* definition of a tax, the Court concluded, "The New York City sales tax involved in that case [*Feiring*] and the obligation imposed by . . . the Social Security Act cannot be distinguished in any material respect." *Id.* at 515. The Court further held that, under the *Feiring* definition, the federal claim was a true tax for priority in bankruptcy because it was compensatory to the government. *Id.* at 517. The Court stated, "[A] tax for purposes of § 64, sub. a (4) [of the Bankruptcy Act] includes any 'pecuniary burden laid upon individuals or property for the purpose of supporting the government,' *by whatever name it may be called*." *Id.* at 515-16

[10] The PBGC brushes aside *New York* by arguing that "the statutory language [was] ambiguous." (PBGC Br. 19). But in *New York*, the Internal Revenue Code clearly identified the amount as a tax. 315 U.S. at 512 n.2. The Court specifically referred to it as a tax for purposes of that statute, but nevertheless examined the substance of the claim for bankruptcy purposes.

(*quoting New Jersey v. Anderson*, 203 U.S. 483, 492 (1906)) (emphasis added).[11]

By contrast, under bankruptcy law, a "penalty" is not enacted for the purpose of supporting the government. *See United States v. Unsecured Creditors Comm. of C-T of Va., Inc. (In re C-T of Va., Inc.)*, 977 F.2d 137, 139 (4th Cir. 1992), *cert. denied*, 113 S. Ct. 1644 (1993) (court determined that an "excise tax" under 26 U.S.C. § 4980 was not a "penalty" but rather a revenue raising statute); *see also In re Caponigri*, 193 F. 291, 292 (S.D.N.Y. 1912) ("[I]n substance, an obligation is penal when its amount is measured neither by the obligee's loss nor by the valuation placed

[11] The IRS does not argue that the *Feiring/New York* definition of a tax is incorrect. The IRS has used a nearly identical definition in its revenue rulings concerning the deductibility of taxes:

> A tax is an enforced contribution, exacted pursuant to legislative authority in the exercise of taxing power, and imposed and collected for the purpose of raising revenue to be used for public or governmental purposes . . . . [T]he question whether a particular contribution or charge is to be regarded as a tax depends upon its real nature. If it is in the nature of a tax, it is not material that it may be called by a different name; and, conversely, if it is not in the nature of a tax, it is not material that it may be so called.
>
> A charge primarily imposed for the purpose of regulation is not a tax, even though it produces revenue.

Rev. Rul. 57-345, 1957-2 C.B. 132, 133, *revoked as to the result by* Rev. Rul. 60-366, 1960-2 C.B. 63, 65; *see Campbell v. Davenport*, 362 F.2d 624, 628 (5th Cir. 1966) (the definition in Rev. Rul. 60-366 is "basically the same definition" as in Rev. Rul. 57-345). In Revenue Ruling 60-366, the IRS noted, "The word 'taxes' as used in [26 U.S.C. § 164] is nowhere defined in the [Internal Revenue] Code, and, it must be 'given its ordinary and commonly accepted meaning as established by the judicial decisions.'" Rev. Rul. 60-366, 1960-2 C.B. at 64 (*quoting United Gas Improvement Co. v. Commissioner*, 25 B.T.A. 1382, 1384 (1932)).

by him upon what he has given in exchange."). The Court has stated that federal claims are penalties, regardless of their label, where they are "imposed at least in part as punitive measures against persons who have been guilty of some default or wrong." *Simonson v. Granquist*, 369 U.S. 38, 40-42 (1962) ("[T]he character of a [federal tax] penalty is by no means changed by calling it a lien.").[12]

Amounts under Section 4971 do not meet the Court's test for a "tax" in bankruptcy. Section 4971 was enacted solely to coerce obedience to statutory pension funding requirements, not to raise revenue to support the government. Section 4971 would fulfill its purpose of enforcing compliance with pension funding laws if no 10% or 100% amounts were ever incurred. The legislative history of ERISA states, "Since the employer remains liable for the contributions necessary to meet the funding standards even after the payment of the excise taxes, it is anticipated that few, if any, employers will willfully violate these standards." H.R. Rep. No. 807, 93rd Cong., 2d Sess. 28 (1974). A detailed itemization of revenues and costs for ERISA in the legislative history reveals that no revenues were projected from Section 4971. *See* S. Rep. No. 383, 93d Cong., 1st Sess. 35-38, 71, 148-49 (1973).[13]

[12] Several other pre-*Feiring* cases illustrate the distinction between taxes and penalties. In addressing constitutional issues not relevant here, the Court expressed the view that a critical difference between a tax and a penalty is that a penalty is imposed for the violation of another statute. *United States v. Constantine*, 296 U.S. 287, 295 (1935); *United States v. La Franca*, 282 U.S. 568, 572 (1931); *Bailey v. Drexel Furniture Co.*, 259 U.S. 20, 38 (1922). A similar distinction assists in understanding the meanings of "tax" and "penalty" in the context of priority in bankruptcy. Claims under Section 4971 are imposed only upon violation of a statutory obligation to fund a pension plan.

[13] The fact that the IRS requires Section 4971 amounts to be reported on a return or that the IRS otherwise treats Section 4971 as a tax in nonbankruptcy situations is not controlling. Furthermore, the (continued...)

Unlike the federal claims in *United States v. New York*, *supra*, the underlying punitive purpose of Section 4971 is undisputed. (Pet. 47a-49a). Section 4971's legislative history states:

> The bill [ERISA] also provides new and more effective *penalties* where employers fail to meet the funding standards. In the past, an attempt has been made to enforce the relatively weak funding standards existing under present law by providing for immediate vesting of the employees' rights, to the extent funded, under plans which do not meet these standards. This procedure, however, has proved to be defective since it does not directly *penalize* those responsible for the underfunding. For this reason, the bill places the obligation for funding and the *penalty for underfunding on the person on whom it belongs--namely, the employer*.

H.R. Rep. No. 807, 93rd Cong., 2d Sess. 28 (1974) (emphasis added). The IRS acknowledged in the lower courts that if the Internal Revenue Code label for its claims does not control, "it would not be able to sustain the position that the section 4971 excise taxes are not penalties." (Pet. 48a-49a).

Not long after Congress enacted ERISA, two Courts of Appeals denied tax priority under the Bankruptcy Act to an exaction under Subtitle D, Miscellaneous Excise Taxes, that was

[13](...continued)
lower courts are not unanimous in their treatment of "penalty excise taxes" even for tax purposes. *Latterman v. United States*, 872 F.2d 564, 570 (3d Cir. 1989) (in holding that 26 U.S.C. § 4975(a) should be treated as a tax for purpose of the Internal Revenue Code, the court expressly stated that bankruptcy considerations were not relevant in that case); *Rockefeller v. United States*, 572 F. Supp. 9, 16 (E.D. Ark. 1982), *aff'd*, 718 F.2d 290 (8th Cir. 1983) ("excise taxes" under 26 U.S.C. § 4941 treated as penalties for tax purposes).

very similar to Section 4971.[14] In both cases, the Courts of Appeals held that the statute was intended to punish the debtor rather than to raise revenue under the *Feiring* definition. *Mahon v. United States (In re Unified Control Sys., Inc.)*, 586 F.2d 1036, 1037-39 (5th Cir. 1978) ("excise tax" imposed under 26 U.S.C. § 4941 was a penalty and not an excise tax for bankruptcy purposes); *United States v. Feinblatt (In re Kline)*, 403 F. Supp. 974, 978 (D. Md. 1975), *aff'd*, 547 F.2d 823 (4th Cir. 1977) ("excise taxes" under 26 U.S.C. § 4941 treated as penalties). The reasoning in these cases applies equally to Section 4971. Therefore, under the long-standing application of the Court's decisions, Section 4971 is a not a tax for purposes of bankruptcy priority.

C. Internal Revenue Code Labels Are Not Conclusive for Purposes of the Bankruptcy Code.

The reasoning of *City of New York v. Feiring* and *United States v. New York*, and their progeny in the lower courts, is firmly grounded in recognized principles of statutory construction. The Court has often recognized that the meaning of words or phrases in one federal statute is not conclusive when applied to another statute: "It is not unusual for the same word to be used with different meanings in the same acts, and there is no rule of statutory construction which precludes the courts from giving to the word the meaning which the Legislature intended it should have in each instance." *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932) (citations omitted); *see Fogerty v. Fantasy, Inc.*, 114 S. Ct. 1023, 1027-28 (1994) (the meaning of the attorney's fees statute in the Civil Rights Act is different

[14] Section 4971 was modeled after the private foundation "excise tax" penalties enacted in 1969, such as 26 U.S.C. § 4941. *See* S. Rep. No. 383, 93d Cong., 1st Sess. 70-71 (1973) ("In accord with present law respecting the excise taxes with regard to private foundations, neither the 5 percent nor the 100 percent taxes [under Section 4971] are to be deductible.").

from a "virtually identical" provision of the Copyright Act); *Director, Office of Workers' Compensation Programs v. Perini N. River Assocs.*, 459 U.S. 297, 320 n.29 (1983) (the term "maritime" has different meanings in 28 U.S.C. § 1333(1) and in § 2(3) of the Longshoremen's and Harbor Workers' Compensation Act); *Massachusetts v. United States*, 435 U.S. 444, 460 n.18 (1978) ("That [26 U.S.C.] § 4491 is called or can be characterized as a 'tax' thus possesses no talismanic significance" for a different purpose); *South Chicago Coal & Dock Co. v. Bassett*, 309 U.S. 251, 259-60 (1940) ("We find little aid in considering the use of the term 'crew' in other statutes having other purposes."); *Price v. United States*, 269 U.S. 492, 500 (1926) ("The meaning properly to be attributed to that word [debt] depends upon the connection in which it is used in the particular statute and the purpose to be accomplished."). Even within the Internal Revenue Code, the Court has stated that the federal tax provisions need not be read *in pari materia*. "In interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes." *United States v. Davis*, 370 U.S. 65, 69 n.6 (1962) (citation omitted).

Thus, the IRS errs in asserting that an Internal Revenue Code "tax" label precludes any inquiry into whether such label is consistent with the purposes of the Bankruptcy Code. In *Helwig v. United States*, 188 U.S. 605 (1903), the Court addressed whether an "additional duty" under the federal Customs Administration Act of 1890 was a "penalty" for purposes of determining jurisdiction of the district courts. *Id.* at 610. The Treasury Secretary argued that because the Act labeled the amount an "additional duty," it could not be considered a "penalty." The Court disagreed, stating that for purposes of the jurisdictional statute at issue:

> [I]t is clear that the sum is not imposed for any purpose of revenue, but is in addition to the duties imposed upon the particular article imported, and in each individual case when

the sum is imposed it is based upon the particular act of the importer. That particular act is his undervaluation of the goods imported, and is without doubt a punishment upon the importer on account of it. Whether the statute defines it in terms as a punishment or penalty is not important, if the nature of the provision itself be of that character.

. . .

[W]hether called a "further sum" or an "additional duty," or by some other name, the amount imposed was so large in proportion to the value of the merchandise imported, as to show beyond doubt that it was a sum imposed not, in fact, as a duty upon an imported article, but as a penalty, and nothing else.

Id. at 611. The Court concluded that, although Congress could have directed that the "additional duty" not be treated as a penalty for jurisdictional purposes, in the absence of such direction, the Court would look to the substance of the assessment. *Id.* at 613.

Therefore, when construing language from two separate federal statutes, it is necessary to examine the purposes for which they were enacted. As Justice Cardozo observed, "Our concern is to define the meaning [of a term] for the purpose of a particular statute which must be read in the light of the mischief to be corrected and the end to be attained." *Warner v. Goltra*, 293 U.S. 155, 158 (1934); *see Claridge Apartments Co. v. Commissioner*, 323 U.S. 141, 146, 160 (1944) (legislation should be construed in accordance with the problem to be addressed).

Ignoring these rules of statutory construction, the IRS criticizes the lower courts for looking at the purposes of Section 507(a)(7)(E) and Section 4971 and for subjecting claims under Section 4971 to the traditional test for tax priority in bankruptcy. (IRS Br. 9, 19). Under the IRS' argument *every* substantive term used in the Internal Revenue Code must have the identical meaning when used in the Bankruptcy Code, as well as in every other federal statute. This argument would impose an unreasonable

burden upon Congress to ensure all terms have precisely uniform meanings throughout the entire United States Code. It is unlikely that the IRS would agree to the use of labels in the Bankruptcy Code to decide issues arising under the Internal Revenue Code. *See Commissioner v. Lincoln Sav. and Loan Ass'n*, 403 U.S. 345, 359 (1971) (finding that "the statutory labels of 'prepayment' and 'additional premium' contained in § 404(d) [of the National Housing Act] are not controlling" for tax purposes).[15]

The Bankruptcy Code governs priorities for claims in bankruptcy cases and courts applying it cannot, in the absence of clear statutory direction, be bound by other statutes serving other purposes. Because priority claims dilute or eliminate payments to general unsecured creditors, the Court has held that "'if one claimant is to be preferred over others, the purpose should be clear from the statute.'" *United States v. Embassy Restaurant, Inc.*, 359 U.S. 29, 31 (1959) (*quoting Nathanson v. NLRB*, 344 U.S. 25, 29 (1952)). In *Embassy Restaurant*, the Court held that claims for contributions by an employer to a union welfare fund were not entitled to priority in bankruptcy as "wages," even

[15] Federal courts and the IRS have addressed issues similar to this case for decades under 26 U.S.C. § 162 which permits the deduction of certain state and federal taxes but not penalties. Neither the courts nor the IRS have felt constrained by the labels used by other federal statutes. In one revenue ruling, the IRS held that a "nonconformance penalty" under the Clean Air Act is not a "penalty" for purposes of Section 162, reasoning, "The legislative history of the NCP shows that it is not punitive in nature. . . . Mere nonconformity within the allowable range of nonconformity *is not a violation of the Act* if there is a payment of the NCP." Rev. Rul. 88-46, 1988-1 C.B. 76, 77 (emphasis added); *see also Colt Industries, Inc. v. United States*, 880 F.2d 1311, 1314 (Fed. Cir. 1989) ("penalties" under Clean Air Act and Clean Water Act are true penalties for § 162 purposes); *Talley Indus. v. Commissioner*, 68 T.C.M. (CCH) 1412, 1418 (1994) (whether a "penalty" under the False Claims Act is a penalty for purposes of § 162 depends upon its compensatory nature).

though such benefits may be considered "wages" under the National Labor Relations Act and the Social Security Act. The Court stated, "We construe the priority section of the Bankruptcy Act, not those statutes." 359 U.S. at 33.

In *Embassy Restaurant*, the Court first noted that the contributions could not be treated as wages "unless it is clear that [the contributions] satisfy the purpose for which Congress established the priority." *Id.* at 34. Furthermore, the Court found it significant that "if the claims of the [welfare plan] are to be treated on a par with wages, in a case where the employer's assets are insufficient to pay all in the second priority, the workman will have to share with the welfare plan, thus reducing his own recovery." *Id.* at 33-34.

The Court has previously rejected arguments that a label in the Internal Revenue Code is determinative of treatment in bankruptcy. In *Simonson v. Granquist*, 369 U.S. 38 (1962), the IRS filed a claim for a tax penalty secured by a valid statutory lien under Section 6321 of the Internal Revenue Code. The IRS argued that its claim was entitled to priority as a secured claim and that the Bankruptcy Court lacked power to avoid a lien valid under the Internal Revenue Code. Brief for the Respondents at 8, *Simonson v. Granquist* (No. 83). The Court held that although the penalty was denominated a "lien" by the Internal Revenue Code, Section 57j of the Bankruptcy Act disallowed all penalties. *See* 11 U.S.C. § 93j (repealed 1978). Noting the different purposes of the two statutes, the Court ruled that the Internal Revenue Code's label did not control and that "the character of a penalty is by no means changed by calling it a lien." 369 U.S. at 42; *see United States v. Sotelo*, 436 U.S. 268, 275 (1978) (an IRS claim under 26 U.S.C. § 6672, although labeled a "penalty," was in essence a tax

for purposes of dischargeability under Section 17(a) of the Bankruptcy Act).[16]

Comparing the purposes of Sections 4971 and 507(a)(7)(E) is both relevant and necessary. The purpose of Section 507(a)(7)(E) is to ensure that the government receives revenues necessary to operate. *See Price v. United States*, 269 U.S. 492, 499-500 (1926) ("[P]riority statutes were enacted to . . . secure adequate public revenue to sustain the public burdens."). Section 4971 has no revenue raising function. Its sole purpose is to protect retirees' pensions and punish plan sponsors who underfund pensions. *See supra* at 20-21. If the IRS' claims had been given priority in the amounts asserted initially, they would have diluted legitimate state and local tax claims and, by defeating the reorganization, would have jeopardized the full funding of the Noncontributory Plan and the recovery of the PBGC, a portion of which would go to the Debtors' retirees for pension benefits not guaranteed by the PBGC. 29 U.S.C. § 1322(c). The single 10% claim on appeal here will, if paid, be paid out of funds that otherwise would be paid to general unsecured creditors, including the PBGC and, through the PBGC, to retirees. The IRS in effect argues that where an insolvent employer is liquidated, Congress intended to

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[16] Since *Sotelo* was decided, the IRS has successfully argued on several occasions that, *for purpose of the Internal Revenue Code*, Section 6672 is a *penalty* and not a tax. Most recently, in *Duncan v. Commissioner*, the Tax Court ruled in favor of the IRS on this issue, stating:

> In [*Sotelo*], the Supreme Court held that sec. 6672 constitutes a "tax," rather than a "penalty," for purposes of dischargeability under the Bankruptcy Act. We stated in *Patton v. Commissioner* [Dec. 35,589], 71 T.C. 389, 390-391 (1978), that the Supreme Court's decision had "no controlling effect upon the meaning of 'penalty' in section 162(f) [of the Internal Revenue Code], which is directed to an entirely different problem."

66 T.C.M. (CCH) 420, 423 n.9 (1993) (citations omitted).

fund the IRS' Section 4971 claims at the direct expense of retirees and other unsecured creditors, not simply once, but in compounding amounts. The IRS' position also forces the incongruous conclusion that Congress intended to grant priority status to alleged "tax" claims based on pension funding deficiencies, when the underlying pension contributions themselves were not given priority. *See Otte v. United States*, 419 U.S. 43, 57 (1974) ("[I]t is anomalous to accord withholding taxes a higher priority than the wage claims to which they so directly relate.").[17]

This absurd result is a strong reason not to interpret these two federal statutes to defeat the purposes of both. Faced with a similar conflict between the IRS' interpretation of a bankruptcy statute and its evident purpose, the Court stated, "To this [result] the Government might be entitled if the statutory mandate were clear. It cannot have that advantage by dubious construction which ignores so much of the statute's setting, purpose and history. The letter does not require this. The consequences forbid it." *Claridge Apartments Co. v. Commissioner*, 323 U.S. 141, 164-65 (1944). If the Court does as the IRS urges in this case and punishes the retirees/plan participants for the Debtors' prepetition failure to meet the minimum funding standards, this truly will be a case where "[t]he cure [is] worse than the disease." *Id.* at 151.

D. The Enactment of the Bankruptcy Code Did Not Alter the Established Meaning of "Tax" for Bankruptcy Purposes.

When the Bankruptcy Code was adopted in 1978, the meaning of "tax" for purposes of bankruptcy priority were correctly governed by the Court's cases, not by labels in nonbankruptcy federal and state statutes. The *Feiring* definition was so well

[17] If the PBGC's claims were entitled to priority, as it asserts, any Section 4971 amounts would be duplicative and an unnecessary enforcement mechanism.

entrenched that Black's Law Dictionary similarly defined a tax as "[a] pecuniary burden laid upon individuals or property to support the government, and is a payment exacted by legislative authority." BLACK'S LAW DICTIONARY 1628 (4th ed. 1968) (citations omitted). A penalty, on the other hand was defined as "a punishment imposed by statute as a consequence of the commission of an offense." *Id.* at 1290 (citations omitted).

If, in enacting the Bankruptcy Code, Congress had intended to elevate formerly disallowed nonpecuniary loss claims to priority status or to modify the well established definition of "tax" for purposes of priority in bankruptcy, one would expect Congress to make a clear statement to that effect. The Court has stated that it is "reluctant to accept arguments that would interpret the [Bankruptcy] Code . . . to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (citations omitted); *see Kelly v. Robinson*, 479 U.S. 36, 53 (1986) (Court noted "the uniform construction of the old [Bankruptcy] Act over three-quarters of a century, and the absence of any significant evidence that Congress intended to change the law in this area . . . ."); *see also Commissioner v. Keystone Consolidated Indus.*, 113 S. Ct. 2006, 2011 (1993) (phrase in the Internal Revenue Code "had acquired a settled judicial and administrative interpretation over the course of a half century before Congress enacted . . . § 4975").[18] Yet the Bankruptcy Code's legislative history has no references to granting priority status to penalty

[18] The IRS gives no explanation why the Bankruptcy Code should be read to change existing law. The PBGC correctly acknowledges that, with respect to tax priorities, Congress intended to maintain the law "as it stood before 1978." (PBGC Br. 12); *see* H.R. Rep. No. 595, 95th Cong., 1st Sess. 190 (1977) ("the kinds of taxes entitled to priority under H.R. 8200 closely follows the categories granted under the Bankruptcy Act"). The IRS' rationale assumes that Congress intended to modify existing law as to federal claims but not state and local claims.

excise taxes of the type denied priority under the Bankruptcy Act in *Mahon v. United States (In re Unified Control Sys., Inc.)*, 586 F.2d 1036, 1037-39 (5th Cir. 1978) and *United States v. Feinblatt (In re Kline)*, 403 F. Supp. 974, 978 (D. Md. 1975), *aff'd*, 547 F.2d 823 (4th Cir. 1977). On the contrary, the legislative history discusses only traditional, transaction-based excise taxes "including sales taxes, estate and gift taxes, gasoline and special fuels taxes, and wagering and truck taxes." 124 Cong. Rec. 32,416 (1978) (statement of Rep. Edwards); *id.* at 34,016 (statement of Sen. DeConcini).[19]

If any Congressional intent is to be inferred from the legislative history of the Bankruptcy Code, it should be that Congress intended to permit courts to continue to apply the accepted and well developed standards that looked beyond statutory labels:

> Thus, any tax liability which *under the Internal Revenue Code or State or local tax law* is payable as a "penalty," in addition to the liability of a responsible person under section 6672 of the Internal Revenue Code, will be entitled to the priority which the liability would receive if it were expressly labeled as a "tax" under the applicable tax law. However, a tax

[19] The IRS resorts often to the wording of the legislative history that "All Federal, State or local taxes generally considered or expressly treated as excises are covered by this category . . . ." (IRS Br. 15, 17, 18, 20). Aside from the fact that the statute does not use these broad terms, this language does not support the IRS' argument. According to this statement, the claim must be a *tax* before determining whether it is "generally considered" or "expressly treated" as an *excise*. Moreover, the IRS agrees that courts are not required to give priority to claims of state governments even though such claims are "expressly treated" as excise taxes under state law. (IRS Br. 19-20 n.11). Therefore, this legislative statement cannot be interpreted to mean that labels are controlling, since it refers to both federal and state taxes.

> penalty which is punitive in nature is given subordinated treatment under section 726(a)(4).

124 Cong. Rec. 32,416 (1978) (statement of Rep. Edwards) (emphasis added); *id.* at 34,016 (statement of Sen. DeConcini).[20]

Congress' purpose in creating a "new, express specification" for excise taxes (IRS Br. 14) was not, as the IRS asserts, to expand the types of claims entitled to tax priority, but rather to avoid the problematic concept of "legally due and owing" under Section 64a of the Bankruptcy Act and to provide specific rules for each type of tax. *See* REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137 Part I, 93d Cong., 1st Sess. 215 (1973) ("The Commission recommends . . . that the rules to determine the tax priority be stated rather than left to a phrase, e.g., 'legally due and owing.'"); *Green v. Beaman (In Re Beaman)*, 9 B.R. 539, 541 (Bankr. D. Or. 1980) ("Congress sought to enumerate types of taxes for the purpose of setting a time under which each tax would become stale and dischargeable.").

E. The IRS Misinterprets the Plain Meaning of Section 507(a)(7)(G) of the Bankruptcy Code.

The IRS relies on a "negative pregnant" argument that because the text of 11 U.S.C. § 507(a)(7)(G) grants priority for penalties that are "in compensation for actual pecuniary loss," no pecuniary loss test was intended for excise taxes under Section 507(a)(7)(E). (IRS Br. 17-18). However, this conclusion presupposes the correctness of the IRS' argument that "excise

[20] The Senate Finance Committee similarly stated that Section 507(a)(7) grants tax priority to "[a]ny fine or penalty, *however denominated*, in addition to the so-called responsible officer 'penalty,' *which actually represents collection of a tax*. (Under the bankruptcy law, such penalties are 'pecuniary loss' penalties.) *Penalties which are punitive in nature are not to receive this priority*." S. Rep. No. 1106, 95th Cong., 2d Sess. 17 (1978) (emphasis added).

taxes" entitled to priority in bankruptcy would ordinarily include nonpecuniary loss claims in the first place. Under traditional tests for claims asserting tax priority in bankruptcy, the term "tax" by definition already incorporates the concept of pecuniary loss. The negative pregnant argument "is weakest when it suggests results strangely at odds with other textual pointers, like the common-law language at work in the statute here." *Field v. Mans*, 116 S. Ct. 437, 446 (1995). In this case, both traditional tests for tax priority and textual pointers contradict the IRS' argument.

Similarly, the IRS argues that if priority excise taxes are required to be pecuniary loss claims, "Congress would not have found it necessary" to provide a separate categories for excise taxes and pecuniary loss penalties. (IRS Br. 18 n.10). This reasoning is flawed in that, despite the IRS' concerns, the Reorganized Debtors have not argued that every excise tax in the Internal Revenue Code should be treated as a penalty under the Bankruptcy Code. In this case, however, the IRS *agreed* that if traditional tests for tax priority in bankruptcy were applied to its Section 4971 claims, "it would not be able to sustain the position that the section 4971 excise taxes are not penalties." (Pet. 48a-49a). The IRS acknowledged "that legislative intent [of Section 4971] indicates the taxes imposed are penalties" for violation of another federal statute. (Pet. 47a). The IRS failed to produce any evidence of pecuniary loss and admitted it had none. (CF&I R. 56). The very structure of Section 4971(b), assessing cumulative annual penalties of 100%, 200%, etc., demonstrates the absurdity of treating these claims as priority taxes in bankruptcy.

The straightforward meaning of Section 507(a)(7)(G) is that specified pecuniary loss tax penalties have tax priority but that nonpecuniary loss tax penalties do not have tax priority. Even though the Bankruptcy Code no longer automatically disallows governmental penalty claims, *see* 11 U.S.C. § 93j (repealed 1978), the Bankruptcy Code continues the disfavored treatment of prepetition nonpecuniary loss penalties. Therefore, the distinction between taxes and penalties maintained in Bankruptcy Act case law

is still relevant. Section 507(a)(7) distinguishes "taxes" from "penalties" by granting priority to five specified kinds of "taxes," certain specified customs duties, and to "a penalty related to" one of the priority tax or customs duty claims, but only if the penalty is "in compensation for actual pecuniary loss." 11 U.S.C. § 507(a)(7)(G). Pecuniary loss tax penalties were given priority under Section 507(a)(7)(G) because Congress considered them to be a tax in the form of a penalty. *See* 124 Cong. Rec. 32,416 (1978) (statement of Rep. Edwards); *id.* at 34,016 (statement of Sen. DeConcini) ("[A]ny tax liability which, under otherwise applicable tax law, is collectible in the form of a 'penalty,' is to be treated in the same manner as a tax liability."). Nothing in Section 507 indicates that Congress intended to grant similar priority to nonpecuniary loss penalties in the form of a tax.

Section 507(a)(7)(G), like Section 507(a)(7)(E), is preceded by the words "only to the extent that such claims are for." In *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988), the Court found that similar terminology in Section 506(b) of the Bankruptcy Code which grants postpetition interest on oversecured claims had the "substantive effect of denying undersecured creditors postpetition interest." *Id.* at 372. Likewise, this phrase in Section 507(a)(7)(G) has the substantive effect of denying tax priority to prepetition nonpecuniary loss penalty claims.

F. The Section 4971 Claims Are Not Imposed on a "Transaction Occurring" as Required by Section 507(a)(7)(E) of the Bankruptcy Code.

Even if the Section 4971 claims were required to be treated as excise taxes, they are not based on a "transaction occurring" as required by Section 507(a)(7)(E) and, therefore, do not fall "literally, and precisely" within the language of that section. (IRS Br. 11). Instead, these claims arise solely because of the nonoccurrence of pension plan contributions. *See Templar v. Shamokin Area Sch. Dist. (In re Templar)*, 170 B.R. 562, 564 (Bankr. M.D. Pa. 1994) ("occupation tax" is an "excise tax" but

is not based on a transaction and is not entitled to § 507(a)(7)(E) priority). The nonpayment of an obligation is not within the ordinary meaning of the term "transaction." A transaction is defined as an

> [a]ct of transacting or conducting any business; negotiation; management; proceeding; that which is done; an affair. Something which has taken place, whereby a cause of action has arisen. It must therefore consist of an act or agreement, or several acts or agreements having some connection with each other, in which more than one person is concerned, and by which the legal relations of such persons between themselves are altered.

BLACK'S LAW DICTIONARY 1668 (4th ed. 1968) (citations omitted). The IRS' comparison of Section 4971 penalties to transaction-based excise taxes such as gasoline, alcohol, tobacco, wagering, estate and gift taxes is therefore inapposite. The Section 4971 assessments arise from the violation of ERISA, not from lawful transactions.

The IRS argues that the "'transaction' taxed under Section 4971 is the act of maintaining a pension plan that is not funded adequately." (Pet. Rep. 2 n.1). But Section 507(a)(7)(E) grants no priority to taxes on "acts" or "activities." Section 507(a)(7)(E) uses the narrower term "transaction." Where Congress wanted a more inclusive description, it used the phrase "excise taxes imposed on particular *activities* or transactions," 11 U.S.C. § 902(2)(B) (emphasis added), or "transaction or *event* that occurred," 11 U.S.C. § 523(a)(7) (emphasis added).

G. The Decision of the Court of Appeals Comports with the Case Law Under the Bankruptcy Code.

After enactment of the Bankruptcy Code, lower federal courts have continued to follow the Court's pre-Code cases, universally holding that true taxes for purposes of bankruptcy law are pecuniary burdens enacted for the purpose of supporting the

government.[21] Under this definition, some courts have treated federal "taxes" as "penalties" for purposes of priority under the Bankruptcy Code. *See, e.g., United States v. Dumler (In re Cassidy)*, 983 F.2d 161, 162-65 (10th Cir. 1992) (an "income tax" treated as a penalty); *Deluxe Check Printers v. United States*, 15 Cl. Ct. 175, 181 (1988), *aff'd in part, rev'd in part on other grounds sub nom. Deluxe Corp. v. United States*, 885 F.2d 848 (Fed. Cir. 1989) (tax under 26 U.S.C. § 4941 treated as a penalty); *see also Texas Am. Oil Corp. v. United States Dep't of Energy*, 44 F.3d 1557, 1571 (Fed. Cir. 1995) (*en banc*) ("restitution" in Petroleum Overcharge and Distribution Act was partially a penalty for bankruptcy purposes).

Other courts, applying the same *Feiring* test, have found certain federal assessments to be taxes, whether or not referred to as "taxes." *United States v. Unsecured Creditors Comm. of C-T of Va., Inc. (In re C-T of Va., Inc.)*, 977 F.2d 137, 139 (4th Cir. 1992), *cert. denied*, 113 S. Ct. 1644 (1993) (court determined that an "excise tax" under 26 U.S.C. § 4980 was in fact a revenue

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[21] The "*Lorber Industries* test" referred to by the IRS and the lower courts is simply a recent derivative of the *New York* and *Feiring* definitions. *See County Sanitation Dist. No. 2 v. Lorber Indus. of Cal., Inc. (In re Lorber Indus. of Cal., Inc.)*, 675 F.2d 1062, 1066 (9th Cir. 1982) (*citing Feiring*); *In re Farmers Frozen Food Co.*, 221 F. Supp. 385, 387 & n.2 (N.D. Cal. 1963), *aff'd sub nom. Dungan v. Department of Agriculture*, 332 F.2d 793 (9th Cir. 1964) (*citing New York* and *Feiring*). The Reorganized Debtors do not assert that the "*Lorber Industries* test" need be adopted by the Court. However, this line of cases demonstrates the universal acceptance of the *New York* and *Feiring* rationales before and after the enactment of the Bankruptcy Code. The IRS' assertion that *Lorber Industries* involved a user fee and that *United States v. Dumler (In re Cassidy)*, 983 F.2d 161 (10th Cir. 1992) involved an income tax is irrelevant. (IRS Br. 19). These cases defined a "tax" under the Bankruptcy Act and Code, respectively, using the Court's prior decisions. The fact that this case involves a claim to excise tax priority is not a significant distinction. (IRS Br. 19-20).

raising statute for purposes of the Bankruptcy Code); *United States v. River Coal Co.*, 748 F.2d 1103, 1106 (6th Cir. 1984) (a "reclamation fee" under the federal Surface Mining Control and Reclamation Act of 1977 was a tax for bankruptcy purposes); *United States v. Plan Comm. of Juvenile Shoe Corp. (In re Juvenile Shoe Corp.)*, 180 B.R. 206, 208 (E.D. Mo. 1994) ("excise tax" under 26 U.S.C. § 4980 was a tax, in part because it is compensatory).

The reasoning of these cases is sound. Tax penalties are meant "to punish those who fail to abide by the taxing structure, and to deter those who might be inclined to avoid tax payment." *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1250 (7th Cir. 1990). In the context of bankruptcy, however, granting priority to claims for prepetition tax penalties would accomplish neither goal; instead, such claims would penalize only other claimants. *Simonson v. Granquist*, 369 U.S. 38, 40-41 (1962). This is particularly true in a case such as this where the former owners of the Debtors, who were responsible to make the pension payments, will receive nothing. Based on the punitive nature of Section 4971, four other cases directly on point have held that IRS claims under Section 4971 are not entitled to priority as a "tax" in bankruptcy. *Seidle v. United States (In re Airlift Int'l, Inc.)*, 120 B.R. 597, 601-02 (S.D. Fla. 1990); *United Steelworkers of Am. v. PBGC (In re Wheeling-Pittsburgh Steel Corp.)*, 103 B.R. 672, 693-94 (W.D. Pa. 1989); *In re Chateaugay Corp.*, 15 Employee Benefits Cas. (BNA) 1237, 1238 (Bankr. S.D.N.Y. Mar. 30, 1992), *rev'd on other grounds sub nom. LTV Corp. v. IRS (In re Chateaugay Corp.)*, 146 B.R. 626 (S.D.N.Y. 1992);[22] *In re Bertsch & Co.*,

[22] Pursuant to a stipulation of the parties, the District Court later vacated its order and the Bankruptcy Court's order in the LTV case. *LTV Corp. v. IRS (In re Chateaugay Corp.)*, 157 B.R. 74 (S.D.N.Y. 1993).

No. IP84-4366RA J, 1988 Bankr. LEXIS 2570, at *6 (Bankr. S.D. Ind. Aug. 15, 1988).[23]

The IRS has cited no decision of the Court, or any decision of any lower court except *United States v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.)*, 942 F.2d 1055 (6th Cir. 1991), *cert. denied sub. nom. Krugliak v. United States*, 502 U.S. 1092 (1992), holding that labels in a nonbankruptcy federal statute are conclusive of the substance of a claim under the federal bankruptcy laws. Every court addressing this issue since the *Mansfield* decision properly has refused to follow it. *See, e.g., United States v. Dumler (In re Cassidy)*, 983 F.2d 161, 162 (10th Cir. 1992); *United States v. Unsecured Creditors' Comm. of C-T of Va., Inc. (In re C-T of Va., Inc.)*, 977 F.2d 137, 139 (4th Cir. 1992).

H. Granting Tax Priority to Section 4971 Claims Would Prevent Reorganization In Many Cases.

Except for the smallest penalty, *i.e.*, a 10% penalty for the 1989 underfunding, the IRS has abandoned all of its other 10% and 100% "tax" claims. (IRS Br. 3 n.3). The IRS tailored its argument in the Court of Appeals by dropping over $40 million in 10% and 100% "tax" claims even though its argument for "excise tax" priority for those claims was exactly the same as its argument for "excise tax" priority for the single 10% "excise tax" claim that remains. Although this relieves the IRS from arguing in this appeal that the cumulative 10% and 100% claims are entitled to

[23] One other lower court has twice addressed Section 4971 claims in a bankruptcy context. In one case the court granted the claims administrative expense priority, *In re Williams Co.*, 81 B.R. 437, 439 (Bankr. N.D. Ohio 1986) and in another case denied such priority, *In re Overly-Hautz Co.*, 57 B.R. 932, 937 (Bankr. N.D. Ohio 1986), *aff'd*, 81 B.R. 434 (N.D. Ohio 1987). The issue of whether Section 4971 claims are "taxes" for bankruptcy purposes was not raised in either case.

priority as "excise taxes," it does not avoid the reality that the basis for claiming excise tax priority for both is identical.

The IRS also avoids having to justify imposing postpetition penalties for the Debtors' compliance with the Bankruptcy Code by not making postpetition minimum funding payments. As the Bankruptcy Court stated in this case:

> Since the basis for the IRS's proofs of claim for these periods is the Debtors' compliance with the Bankruptcy Code, it would be inequitable to allow the claims. Any failure to make such contribution is protected under bankruptcy law and cannot be penalized by the IRS.

(Pet. 54a).

Acceptance of the IRS' argument would virtually ensure tax priority treatment for prepetition and postpetition 100% penalties for purposes of Sections 507(a) and 503(b) of the Bankruptcy Code. *See Claridge Apartments Co. v. Commissioner*, 323 U.S. 141, 162 (1944) ("The possibility that uniform interpretation may be required gives pause, at least, before adopting a view in this case which, if extended to the other provisions, would open so wide a door . . . .").

As the IRS has stated, "claims asserted under Section 4971 alone accumulate to hundreds of millions of dollars annually." (Pet. Rep. 2). A decision granting such claims priority in bankruptcy cases would devastate the reorganization efforts of companies like CF&I. Former general counsel for the PBGC has written that "[t]he implications of such a holding for debtors and their creditors are obvious--and enormous." Flowe, *Beware Financial Impact of Supreme Court Ruling*, 28 BANKRUPTCY COURT DECISIONS: WEEKLY NEWS AND COMMENT, Jan. 16, 1996, at A1, A8, A10 ("Priority claims of this magnitude could easily cause many reorganizations to become liquidations."). If the IRS were correct, then Chapter 11 reorganization would no longer be possible for a company that cannot afford its pension plan. Voluntary distress termination of a pension plan under 29

U.S.C. § 1341(c)(3)(B)(ii) takes time, particularly in a case like this where a collective bargaining agreement stands in the way of termination. 29 U.S.C. § 1341(a)(3); 11 U.S.C. § 1113(f). During this time, according to the IRS, Section 4971 "taxes" accrue at multiplying 10% and 100% rates. As these "taxes" consume available assets, reorganization becomes impossible.

There is no sound basis for the IRS' fear that every excise tax will be treated as a nonpriority claim in bankruptcy. Courts have already demonstrated an ability to distinguish between an excise tax and a penalty for bankruptcy purposes without prejudicing the legitimate pecuniary interests of the IRS. Only two exactions under Subtitle D, Miscellaneous Excise Taxes, 26 U.S.C. §§ 4941 and 4971 have been found not to be entitled to priority. *See supra* at 22, 35-36. Unlike the "gas guzzler," "ozone depleting chemicals," "golden parachute," and "greenmail" exactions highlighted by the IRS (IRS Br. 16-17), claims under Section 4971 are imposed only upon violation of a statute.

The IRS' and PBGC's assertion that granting priority to Section 4971 claims will coerce pension funding is not logical. (IRS Br. 27-28; PBGC Br. 23-25). Whether the Section 4971 amounts are paid before or after unsecured creditors does not affect the employer's liability or incentive to fund the pension plans. If a pension plan sponsor is insolvent, as in this case, a priority in bankruptcy for unpaid prepetition claims under Section 4971 could have the opposite result by encouraging creditors to initiate premature bankruptcy filings timed to precede upcoming funding payments, a perverse incentive not likely intended by Congress.

II. THE IRS' CLAIMS UNDER SECTION 4971 WERE PROPERLY SUBORDINATED TO THE CLAIMS OF GENERAL UNSECURED CREDITORS.

A. Subordination of the IRS' Claims Was Proper Under the Plan

By focusing on 11 U.S.C. § 510(c), the IRS and the PBGC ignore other provisions of the Bankruptcy Code that required the Plan to classify separately and to subordinate the Section 4971 claims.[24] Before a Chapter 11 plan may be confirmed, Section 1129(a)(7) of the Bankruptcy Code requires that each creditor holding an impaired claim either (i) vote to accept the plan or (ii) receive an amount not less than the creditor would receive if the debtor were liquidated under Chapter 7. 11 U.S.C § 1129(a)(7). The IRS concedes that prepetition penalty claims are automatically subordinated in a Chapter 7 case pursuant to 11 U.S.C. § 726(a)(4). (IRS Br. 28-29). In a liquidating Chapter 11 case such as this one, prepetition penalty claims likewise must be subordinated if an unsecured creditor is to receive as much as under Chapter 7. Thus, while Chapter 7 subordination provisions do not apply directly in Chapter 11 cases, *see* 11 U.S.C. § 103(b), Section 1129(a)(7) requires reference to them in determining whether Chapter 11 plans can be confirmed: "In order to determine the hypothetical distribution in a liquidation [under Section 1129(a)(7)], the court will have to consider the various subordination provisions of proposed 11 U.S.C. 510, 726(a)(3), 726(a)(4). . . ." H.R. Rep. No. 595, 95th Cong., 1st Sess. 412 (1977).[25]

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[24] Federal Rule of Bankruptcy Procedure 7001(8) recognizes that subordination may be provided in a Chapter 11 plan.

[25] Section 726(a)(4) specifies a subordinated fourth priority for claims "for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty,

(continued...)

The Bankruptcy Court specifically found that, under the provisions of the Plan subordinating the Section 4971 claims, creditors would receive at least as much as if the Debtors were liquidated under Chapter 7. (Pet. 28a). The IRS has not contested this finding. Since the Plan did not pay holders of unsecured claims in full, failure to subordinate the IRS' claims would have been directly contrary to the language of Section 1129(a)(7) and would have prevented confirmation of the Plan. Section 1129(a)(7) is satisfied with respect to the IRS, since its claims would have been subordinated in Chapter 7 and not entitled to a distribution.[26]

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[25](...continued)

forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim." In order to comply with Section 1129(a)(7), Class 13 of the Plan matches this language: "This Class consists of all Allowed Claims which are Claims for penalties under any agreement or any applicable law, including, without limitation, all Claims of the IRS pursuant to 26 U.S.C. Section 4971, all Claims of state and local taxing authorities for tax-related penalties, and any other Claims for any fine, penalty or forfeiture, or for multiple, exemplary or punitive damages, to the extent that such Claims are not compensation for actual pecuniary loss suffered by the holders of such Claims." (CF&I R. 141).

[26] In a Chapter 11 case where the debtor continued in business and the debtor's owners retained interests, subordination of nonpecuniary loss penalty claims might not be proper. In Chapter 11 cases such as this, where unsecured creditors will receive less than the full value of their claims and owners receive nothing, there is no valid reason to require that creditors pay nonpecuniary loss penalties. *See Schultz Broadway Inn v. United States*, 912 F.2d 230, 233-34 (8th Cir. 1990) (in a liquidating Chapter 11, nonpecuniary loss penalties should not be treated differently than under Chapter 7). Section 726(a)(4) is not, as the IRS assumes, proof that nonpecuniary loss penalties cannot be subordinated in Chapter 11 cases. The wide range of circumstances possible in Chapter 11 explains why in Chapter 11 cases subordination of nonpecuniary loss penalty claims is left to a case by case determination,

(continued...)

The theme of the IRS' argument against subordination is that a Bankruptcy Court cannot alter statutorily created "categories" of claims. (IRS Br. 12, 24, 25 n.13, 26, 28, 29). The PBGC similarly argues that what occurred here was "reshuffling of the legislated priorities." (PBGC Br. 21). What the IRS and the PBGC overlook is that Chapter 11 nowhere requires a unitary "category" for all general unsecured claims. The lower courts did not, therefore, "disregard categories of priorities specified by statute" (IRS Br. 23), because no such statutory categories for general unsecured claims exist.[27] The IRS recognizes that unlike *United States v. Noland* argued in tandem with this case, its claims here do not have a specific statutory priority. (IRS Br. 9 n.6).

The Bankruptcy Code required separate classification of the Section 4971 claims. Chapter 11 requires a plan to "designate" "classes of claims." 11 U.S.C. § 1123(a)(1). Claims within a class designated by a Chapter 11 plan must be "substantially similar." 11 U.S.C. § 1122(a). General unsecured claims and nonpecuniary loss penalties are not substantially similar because they have different priorities in Chapter 7 and because the former represent a pecuniary loss while the latter do not. Therefore, the Plan in this case could not have placed pecuniary loss and nonpecuniary loss claims in the same class.

The Bankruptcy Court found, and the IRS does not dispute, that the Plan complied with the classification requirements of Chapter 11. (Pet. 27a). The IRS did not challenge the Plan's creation of a separate subordinated class for nonpecuniary loss

[26](...continued)
as opposed to the automatic subordination mandated in every case under Chapter 7.

[27] Chapter 11 "does not require all nonpriority prepetition unsecured claims to be placed within a single class. [T]he Code . . . implicitly recognizes that separate classification of unsecured claims may be appropriate." 5 COLLIER ON BANKRUPTCY ¶ 1122.03[4], at 1122-11 to 1122-12 (15th ed. 1995).

claims, limiting its arguments to the inclusion of its Section 4971 "tax" claims in that class. Yet if, as the lower courts found, the IRS' Section 4971 claims are not entitled to priority as taxes, there is no basis for exempting the IRS from the provisions of the Bankruptcy Code or treating its nonpecuniary loss penalty claims better than like claims of other creditors.[28]

Furthermore, if the Section 4971 claims had been classified with other unsecured creditors, the Bankruptcy Code would have required that they be treated equally with other claims in the class, 11 U.S.C. § 1123(a)(4), thereby making it impossible to meet the requirements of Section 1129(a)(7). Accordingly, separately classifying and providing subordinated treatment for nonpecuniary loss penalty claims in a case such as this was both necessary and proper.

Disputes over separate classification of claims in a Chapter 11 plan are resolved not only by the requirements of Section 1129(a)(7) but also by the "unfair discrimination" and "fair and equitable" tests of 11 U.S.C. § 1129(b). *Steelcase, Inc. v. Johnson (In re Johnson)*, 21 F.3d 323, 328 (9th Cir. 1994); 5 COLLIER ON BANKRUPTCY, ¶ 1122.04, at 1122-22 (15th ed. 1995). The Bankruptcy Court found that each of these requirements was satisfied under the Plan (Pet. 27a-29a) because failure to subordinate nonpecuniary loss penalty claims would have punished creditors who suffered pecuniary losses for the Debtors'

[28] *See Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 58-59 & n. 14 (1989) ("By submitting a claim against the bankruptcy estate, creditors subject themselves to the court's equitable power to disallow those claims . . . . "); *cf. United States v. Whiting Pools, Inc.*, 462 U.S. 198, 209 (1983) (IRS is bound by § 542(a) of the Bankruptcy Code "to the same extent as any other secured creditor").

violation of ERISA funding requirements.[29] These findings are unchallenged.

B. Subordination of the IRS' Claims Was Proper Under Bankruptcy Code Sections 510(c) and 502(j).

The lower courts also properly subordinated the IRS' claims under Section 4971 pursuant to the equitable powers conferred on the Bankruptcy Court under 11 U.S.C. §§ 510(c) and 502(j). The Bankruptcy Court found that allowing the IRS the same distributive priority as the PBGC and other general unsecured creditors would advance neither the legislative purpose of Section 4971 nor the principle of equality of distribution that underlies the Bankruptcy Code. Instead it would punish creditors. (Opp. 4a).[30]

[29] Separate classification of nonpecuniary loss penalty claims in a case lacking sufficient assets to pay pecuniary loss claims is also fair because nonpecuniary loss claims contributed nothing to the value of the assets. *See In re Four Seasons Nursing Ctrs. of Am., Inc.*, 472 F.2d 747, 750 (10th Cir. 1973) (approving plan's subordinated class of interests that "introduced no fresh money and did not directly or indirectly contribute substance to either the debtor corporation or the reorganized corporation."); *cf.* 3 COLLIER ON BANKRUPTCY ¶ 57.22[1], at 382 (14th ed. 1977) ("[T]here is an undeniable equity in the postulate that participation in the estate should be denied to a creditor who has neither in some degree contributed to the distributable funds . . . nor has suffered a pecuniary loss by parting with something in money's worth.") (discussing disallowance of penalties under former law).

[30] *Cf. Simonson v. Granquist*, 369 U.S. 38, 40-41 (1962) ("[T]he prohibition of all tax penalties in bankruptcy [under former law] is wholly consistent with the policy of the penalty provisions themselves. Tax penalties are imposed at least in part as punitive measures against persons who have been guilty of some default or wrong. Enforcement of penalties against the estates of bankrupts, however, would serve not to punish the delinquent taxpayers, but rather their entirely innocent creditors."); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945)
(continued...)

The Court's equitable subordination decisions in *Comstock v. Group of Institutional Investors*, 335 U.S. 211 (1948), *Pepper v. Litton*, 308 U.S. 295 (1939), and *Taylor v. Standard Gas & Electric Co.*, 306 U.S. 307 (1939) did not address subordination of governmental nonpecuniary loss penalty claims because the Bankruptcy Act disallowed such claims. 11 U.S.C. § 93(j) (repealed 1978); *Simonson v. Granquist*, 369 U.S. 38, 40-41 (1962).[31]

Equitable subordination in *Pepper* and *Taylor* protected innocent creditors from harm by subordinating the claims of creditors who violated fiduciary obligations and mismanaged corporate affairs. Subordination of the IRS' claims in this case also protected innocent creditors from harm by refusing to punish them for the Debtors' violation of ERISA.

[30](...continued)
("[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another."); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941) ("[T]he theme of the Bankruptcy Act is equality of distribution.").

[31] The IRS cites no pre-Code precedent refusing to subordinate a nonpecuniary loss penalty. The IRS erroneously implies that no pre-Bankruptcy Code cases subordinated claims on grounds other than inequitable conduct. *But see Jezarian v. Raichle (In re Stirling Homex Corp.)*, 579 F.2d 206, 212-13 (2d Cir. 1978) (subordinating claims of innocent defrauded stock purchasers to those of general unsecured creditors); *In re Four Seasons Nursing Ctrs. of Am., Inc.*, 472 F.2d 747, 750 (10th Cir. 1973) (approving separate classification and subordination under plan of purchasers of common stock, based on date of purchase). The Court's opinion in *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946), denying interest on interest a reorganization court ordered not to be paid, has been regarded by the Court of Appeals for the Fifth Circuit as a subordination decision. *Fahs v. Martin*, 224 F.2d 387, 395 n.5 (5th Cir. 1955).

In *Pepper*, the Court noted that bankruptcy courts traditionally exercised their equitable powers "to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done." 308 U.S. at 305. While the present case does not involve fraud or violation of fiduciary obligations, it does involve the assertion by the IRS that the form (*i.e.*, the label) of its claim must prevail over its substance, and that technical considerations (*i.e.*, exacting a penalty incurred by and directed at the Debtors when the Debtors are liquidated and only creditors can pay) must prevail over substantial justice, as specifically determined by the Bankruptcy Court on the facts of this case. The Court of Appeals' decision in this case is therefore not a departure from established precedent, but instead an application of equitable principles in a factual setting which had not arisen under prior law.

Comstock stands for the principle that *Pepper* and *Taylor* do not require subordination of a claim where (i) subordination "would unjustly enrich" the objecting creditors, (ii) the challenged claim "was the outgrowth of complicated but legitimate good faith business transactions," (iii) neither the "design or effect of the transaction produced injury to the [objecting creditor] or the interests for which he speaks," and (iv) the claimant's actions were "established as beneficial rather than injurious to the interests which now challenge them." 335 U.S. at 229-230. *Comstock* in no way forbids subordination of the IRS' penalty claims in this case where the Bankruptcy Court found that their payment "would defeat any attempt by the Debtors to reorganize, would prevent any return to creditors[,] . . . would provide a windfall to the IRS [, and] . . . would harm the parties that are intended to be protected by the pension plan that section 4971 seeks to enforce, because payment of section 4971 penalty claims would be at the expense of prepetition unsecured creditors including pensioners." (Pet. 51a).

The Bankruptcy Code did not remove the traditional powers of Bankruptcy Courts to allow or disallow claims, reject claims in

whole or in part, or subordinate claims in light of equitable considerations. Section 502(j), which permits reconsideration and allowance or disallowance "according to the equities of the case," is the statutory successor of Section 57k of the Bankruptcy Act.[32] The Court in *Pepper* read Section 57k as follows: "For certainly if, as provided in the latter section, a claim which has been allowed may be later 'rejected in whole or in part, according to the equities of the case,' disallowance or subordination in light of equitable considerations may originally be made." 308 U.S. at 305. Section 502(j) grants the same powers that include, as *Pepper* reasoned, the power to subordinate claims in the first instance based on the "equities of the case."

Section 510(c) expressly permits subordination of claims "for purposes of distribution" based on "principles of equitable subordination." The Court of Appeals correctly rejected the IRS' nontextual arguments for limits on Section 510(c). The text of Section 510(c) does not require a finding of inequitable conduct[33] or freeze principles of equitable subordination in time by forever terminating the power of courts to make precedents as new circumstances arise.[34]

[32] Here, the IRS' claims were "deemed allowed" when filed, subject to objection and reconsideration. 11 U.S.C. § 502(a).

[33] The Courts of Appeals are in unanimous agreement with the Court of Appeals in this case that, in the narrow context of nonpecuniary loss penalties, equitable subordination under 11 U.S.C. § 510(c) does not require a finding of inequitable conduct. *United States v. Noland (In re First Truck Lines, Inc.)*, 48 F.3d 210, 218 (6th Cir. 1995), *cert. granted*, No. 95-323 (Dec. 1, 1995); *Burden v. United States*, 917 F.2d 115, 120 (3d Cir. 1990); *Schultz Broadway Inn v. United States*, 912 F.2d 230, 233 (8th Cir. 1990); *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1250 (7th Cir. 1990).

[34] The history of creditors' rights in liquidation demonstrates that equitable principles are capable of growth. *See* GLENN, THE LAW GOVERNING LIQUIDATION § 554, at 798 (1935) (With reference to

(continued...)

Section 502(j) and Section 510(c) specify that reconsideration or equitable subordination are to be based on "equities of the case" and "principles of equitable subordination." The phrase "principles of equitable subordination" was drafted to permit judicial development:

> It is intended that the term "principles of equitable subordination" follow existing case law and leave to the courts development of this principle. To date, under existing law, a claim is generally subordinated only if [the] holder of such claim is guilty of inequitable conduct, *or the claim itself is of a status susceptible to subordination, such as a penalty* . . . .

124 Cong. Rec. 33,998 (1978) (statement of Rep. Edwards) (emphasis added); *id.* 32,398 (statement of Sen. DeConcini).[35]

All Courts of Appeals considering this issue have concluded that prepetition penalty claims not involving pecuniary losses may be equitably subordinated.[36] With only one exception known to

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[34](...continued)
development of equitable rules concerning tracing of trust funds in bank failures, "Sir George Jessel took pains to say, in his judgment in the great case of Hallett's Estate [*Knatchbull v. Hallett (In re Hallett's Estate), 13 Ch. D. 696 (C.A. 1880)*], that equity was capable of growth, and was growing in his time.").

[35] The IRS' summary of the legislative history of Section 510(c) omits the express reference to subordination of penalties. (IRS Br. 25 n. 13). Even the portion of the report quoted by the IRS clearly states that "a claim *normally* may be a portion of the subordinated only it its holder is guilty of misconduct." (*Id.*) (emphasis added). This obviously leaves the door open for equitable subordination in the narrow class of claims for nonpecuniary loss penalties.

[36] *See, e.g., Burden v. United States,* 917 F.2d 115, 120 (3d Cir. 1990) (federal tax penalty may be subordinated); *Schultz Broadway Inn v. United States,* 912 F.2d 230, 234 (8th Cir. 1990) (federal tax penalties (continued...)

the Reorganized Debtors,[37] the federal courts addressing the precise issue have held that Section 4971 penalty claims should be equitably subordinated under Section 510(c), whether or not the taxing authority engaged in any misconduct. *See Seidle v. United States (In re Airlift Int'l, Inc.),* 120 B.R. 597, 601-02 (S.D. Fla. 1990); *In re Chateaugay Corp.*, 15 Employee Benefits Cas. (BNA) 1237, 1238-39 (Bankr. S.D.N.Y. Mar. 30, 1992), *rev'd on other grounds sub nom. LTV Corp. v. IRS (In re Chateaugay Corp.)*, 146 B.R. 626 (S.D.N.Y. 1992); *In re Bertsch & Co.*, No. IP84-4366RA J, 1988 Bankr. LEXIS 2570, at *6-7 (Bankr. S.D. Ind. Aug. 15, 1988). Applying traditional equitable considerations and long-standing principles of bankruptcy law to the narrow context of nonpecuniary loss penalty claims, these courts correctly concluded that nonpecuniary loss penalty claims under Section 4971 should be subordinated so as to avoid loss to the general unsecured creditors who suffered pecuniary loss.

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[36](...continued)
subordinated); *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1250 (7th Cir. 1990) (punishing "innocent creditors because of [the debtor's] wrongful conduct serves no purpose").

[37] The solitary anomaly is *United States v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.),* 942 F.2d 1055 (6th Cir. 1991), *cert. denied sub. nom. Krugliak v. United States,* 502 U.S. 1092 (1992), which is of questionable value as a precedent on the issue of subordinating tax penalties in view of that Court's aberrational holding that the Section 4971 liabilities were not penalties.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

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No. 95-325

In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., COLORADO & UTAH LAND COMPANY, KANSAS METALS COMPANY, ALBUQUERQUE METALS COMPANY, REORGANIZED PUEBLO METALS COMPANY, DENVER METALS COMPANY, REORGANIZED PUEBLO RAILROAD SERVICE COMPANY, REORGANIZED CF&I FABRICATORS OF COLORADO, INC., REORGANIZED CF&I STEEL CORPORATION, AND REORGANIZED COLORADO AND WYOMING RAILWAY COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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TABLE OF AUTHORITIES

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1. The first question presented in this case is whether a claim for the excise tax imposed under Section 4971(a) of the Internal Revenue Code is entitled to the priority granted to "an excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E)(1988).

a. Excise taxes are frequently imposed by Congress with the principal purpose of deterring undesired conduct rather than simply raising revenue. Section 4971 is one of the substantial number of federal excise taxes that have a deterrent purpose (Pet. Br. 15-17). The excise tax imposed by Section 4971(a) is designed to insure prompt compliance with the funding obligations of qualified pension plans (Pet. Br. 14).

The priority that Congress afforded to this excise tax in Section 507(a)(7)(E) of the Bankruptcy Code has "an extremely beneficial effect on pension funding" by ensuring that employers—and competing creditors who can force an involuntary reorganization of the employer—cannot evade pension obligations by commencing a bankruptcy case (Amicus PBGC Br. at 2). For example, respondents state that a significant reason for their bankruptcy filing was the accrual of unpaid pension funding obligations (Resp. Br. 3). If creditors could, by forcing an employer into bankruptcy and obtaining a liquidation of its assets, reduce the portion of those assets to be paid in satisfaction of outstanding pension funding obligations, the creditors would thereby benefit at the expense of plan participants and the pension benefit guaranty system of the United States. The bankruptcy priority afforded to the Section 4971(a) excise tax reduces the financial incentives that employers, and their creditors, would otherwise have to evade the timely funding of pension obligations.[1]

[1] Respondents claim that it was "incongruous" for Congress to grant priority to the excise tax imposed by Section 4971(a) over the claims of the PBGC or of the direct beneficiaries of the plan (Resp. Br. 28; see also United Steel Workers Amicus Br. at 14). That contention improperly focuses solely on the consequences of the priority for a particular plan. Respondents fail to recognize that, by diminishing the economic incentive that otherwise exists for an employer to refuse to make plan payments in anticipation of a bankruptcy filing, the priority provided for the Section 4971(a) excise tax seeks to insure the full and timely funding of *all* pension plans in *advance* of bankruptcy. See H.R. Rep. No. 807, 93d Cong., 2d Sess. 28 (1974).

b. In enacting the Bankruptcy Code in 1978 and granting a specific priority to excise taxes for the first time, Congress did not distinguish among excise taxes based on their purpose.[2] Instead, the unqualified text of Section 507(a)(7)(E) reflects what its history clearly states: the statutory priority for "excise taxes" extends to any "Federal, State or local taxes generally considered or expressly treated as excises." 124 Cong. Rec. 32,416 (1978) (Rep. Edwards). See Pet. Br. 13.

[2] By contrast, as we have noted, in providing a limited priority for prepetition "penalties" in Section 507(a)(7)(G), Congress *did* distinguish among such claims based on whether or not their "purpose" was to compensate the government for a "pecuniary loss." See 11 U.S.C. 507(a)(7)(G); Pet. Br. 17-18. If Congress had intended, as respondents contend, to exclude from the priority for "excise taxes" in Section 507(a)(7)(E) any excise tax that might be "punitive" rather than "compensatory" in nature, it had to look no further than Section 507(a)(7)(G) for a model.

As discussed in our opening brief (Pet. Br. 17-18 n.10), an excise tax granted priority under Section 507(a)(7)(E) need not *also* fit within the priority granted in Section 507(a)(7)(G) to penalties "related to a [priority tax] claim * * * and in compensation for actual pecuniary loss." The courts below erred precisely in concluding that an excise tax that would not qualify for priority under the latter provision also must be denied priority under the former.

Recognizing that "many, if not most of the excise taxes contained in * * * the Internal Revenue Code are intended to discourage undesirable conduct," the Sixth Circuit correctly held in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d 1055, 1058 (1991), cert. denied, 502 U.S. 1092 (1992), that "Congress granted priority to excise tax claims without regard to whether their purpose was primarily regulatory." For the reasons explained in detail in our opening brief (Pet. Br. 13-20), the court of appeals erred in this case by denying priority to the Section 4971(a) excise tax on the ground that it is principally a "penalty" and only secondarily designed to raise revenue.

c. Respondents devote a large portion of their brief (Resp. Br. 14-29) to the proposition that, under the case law developed under the pre-1978 Bankruptcy Act, the tax imposed by Section 4971 is more like a "penalty" than a "tax." That issue might have had relevance under the former Bankruptcy Act, which distinguished between "taxes" and "penalties" and had no specific priority for "excise taxes." But it is not relevant in deciding the proper scope of the specific, new priority that Congress provided in 1978 for "excise taxes," which are commonly "punitive" or "deterrent" in nature. See Pet. Br. 16. Instead, Congress indicated that the priority for "excise taxes" applies to all exactions "expressly treated" or "generally considered" as excises. 124 Cong. Rec. at 32,416. See also note 1, *supra*.

Moreover, the pre-1978 decisions of this Court on which respondents seek to rely (Resp. Br. 16-19) do not purport to distinguish "excise taxes" from penalties. Two of the three decisions that respondents cite dealt with the question whether a particular state exaction was a "tax" within the former provisions of the Bankruptcy Act. *City of New York* v. *Feiring*, 313 U.S. 283 (1941); *New Jersey* v. *Anderson*, 203 U.S. 483 (1906). The third decision concerned whether an employer's responsibility to remit withheld federal taxes owed by employees was a priority "tax" or an unsecured "debt," as the employer contended. *United States* v. *New York*, 315 U.S. 510, 513 (1942).

Contrary to respondents' contention (Resp. Br. 18), the Court in *United States* v. *New York* did not suggest that it is appropriate to look behind the "label" that Congress employs in designating what is a "tax" and what is a "penalty" for purposes of the priorities that then applied under the Bankruptcy Act. To the contrary, the Court suggested only that an exaction that Congress had *not* specifically labelled as a "tax" could nonetheless qualify as a "tax" under the Bankruptcy Act if it possessed characteristics that generally indicated it to be a tax. See 315 U.S. at 515.[3] In providing the new, specific priority for "excise taxes" under the Bankruptcy Code, Congress expressed a consistent intention—that any exaction that it had "expressly treated" as an excise tax *or* that was "generally considered" to be an excise tax would be entitled to priority. 124 Cong.

[3] In *United States* v. *New York*, the Court cited *City of New York* v. *Feiring*, *supra*, for the proposition that the duty to pay over a withheld tax is itself the duty to pay a "tax" for purposes of the then-applicable priority provisions of the Bankruptcy Act. 315 U.S. at 515. The Court also rejected the suggestion that related tax credit provisions represented a "penalty." See *id.* at 516-517. In doing so, however, the Court did not cite or refer to *City of New York* v. *Feiring*, as respondents erroneously imply (Resp. Br. 18-19).

Rec. at 32,416 (Rep. Edwards); *id.* at 34,016 (Sen. DeConcini).[4]

As the court stated in *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1060, Congress did not intend "to have its *own* characterizations of payments as 'taxes' subject to second-guessing by the federal courts." See *id.* at 1059:

> While a federal court may ultimately be called upon to decide the question where a state or local exaction is at issue, in this case we are concerned with a federal excise tax. Where Congress has exercised its constitutitonal power and deemed an exaction an "excise tax," the question has been answered.

d. Respondents nonetheless claim that the legislative history of Section 507(a)(7)(E) of the Bankruptcy Code reflects that the statutory priority extends only to "traditional, transaction-based excise taxes" rather than to "penalties" (Resp. Br. 29-30) and does not reach excise taxes "imposed only upon violation of a statute" (Resp. Br. 39). They base this proposition exclusively on the portion of the legislative history that lists, as examples of excise taxes, "sales taxes, estate and gift taxes, gasoline and

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[4] The reasoning of this Court's pre-1978 decisions under the Bankruptcy Act remains relevant under the Bankruptcy Code in classifying exactions that are not designated as "taxes" (see *United States* v. *River Coal Co.*, 748 F.2d 1103 (6th Cir. 1984); *LTV Steel Co.* v. *Shalala* (*In re Chateaugay Corp.*), 154 B.R. 416 (S.D.N.Y 1993)) and in classifying exactions of state or local governments (see *Ohio Bureau of Workers' Compensation* v. *Yoder*, 36 F.3d 484 (6th Cir. 1994); *In re Payne*, 27 B.R. 809 (Bankr. D. Kan. 1983)).

special fuel taxes, and wagering and truck taxes" (124 Cong. Rec. at 32,416).

But the examples contained in this non-exclusive list include excise taxes that could be considered to have a "punitive" or "deterrent" purpose. Moreover, at least one of these excise taxes is "imposed only upon violation of a statute." For example, the "wagering" tax is imposed under Section 4401 of the Internal Revenue Code on persons engaged in the business of accepting wagers and is levied at two different rates. For "any wager authorized under the law of the State in which accepted," the excise tax is 0.25 percent of the wager; for wagers that are not authorized under state law, the excise tax is eight times higher—2.00 percent of the wager. 26 U.S.C. 4401(a). The significantly higher rate of the excise tax for unauthorized wagers is obviously designed to discourage and deter unlawful behavior. The inclusion in the legislative history of Section 507(a)(7)(E) of "wagering" taxes as an example of excise taxes that fall within the scope of the statutory priority indicates, as the plain language of the statute reflects, that Congress did not intend to deny priority to any federal excise tax simply because it has a "punitive" or "deterrent" purpose. See also Pet. Br. 16 (listing examples of federal excise taxes, such as the excise tax on unlawfully issued securities (26 U.S.C. 4701) and the excise tax on excess lobbying by public charities (26 U.S.C. 4911)); note 1, *supra*.

Nor are respondents correct in their assertion (Resp. Br. 33-34) that the excise tax imposed by Section 4971(a) is not within the statutory priority because it is not imposed on a "transaction." Section 507(a)(7)(E) provides priority to "an excise tax on * * * a transaction occurring before the date of the

filing of the petition" (11 U.S.C. 507(a)(7)(E)(i)). Even though Congress unquestionably intended this excise tax priority to have a broad scope (see page 3, *supra*), respondents claim that the term "transaction" should be narrowly construed and does not include the "act of maintaining a pension plan that is not funded adequately" (Resp. Br. 34).

The ordinary definition of "transaction" contradicts respondents' contention. The word has a broad and flexible meaning; it refers (*Black's Law Dictionary* 1668 (4th ed. 1968) (emphasis added)) to an:

> [a]ct of transacting or conducting any business; negotiation; management; proceeding; that which is done; an affair. * * * Something which has taken place, whereby a cause of action has arisen. It must therefore consist of *an act* or agreement, *or several acts* or agreements having some connection with each other, *in which more than one person is concerned, and by which the legal relations of such persons between themselves are altered.*

The "act of maintaining a pension plan that is not funded adequately" fits squarely within this standard definition of the word "transaction"—a definition that respondents adopt and concede is applicable here (Resp. Br. 34). In *United States* v. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059 n.4, the Sixth Circuit therefore correctly rejected respondents' claim that the excise tax under Section 4971(a) is not imposed on a "transaction" within the meaning of Section

507(a)(7)(E). No other court has ruled to the contrary.[5]

e. Respondents err in stating that it is the government's position that "*every* substantive term used in the Internal Revenue Code must have an identical meaning when used in the Bankruptcy Code, as well as in every other federal statute" (Resp. Br. 24). Our submission does not advance that broad proposition.

This case concerns only whether, by enacting a statutory priority for "excise taxes" in Section 507(a)(7)(E) of the Bankruptcy Code, Congress created a priority that encompasses the excise tax imposed by Section 4971(a) of the Internal Revenue Code. It would, indeed, have been odd for Congress to have referred specifically to the Internal Revenue Code in describing the "excise tax" priority in Section 507(a)(7)(E), for the statute provides priority not only for federal excises but for state and local excises as well. Congress, however, *did* express its understanding that the taxes that it has "expressly treated" as excises, as well as other exactions "generally considered" to be excises, are encompassed within the priority for "excise taxes" created by Section 507(a)(7)(E). See 124 Cong. Rec. at 32,416 ("All Federal, State or local taxes generally considered or expressly treated as excises are covered by this category."). See also note 2 *supra*.

f. Respondents attempt to inject a far different set of questions into this case than are in fact presented. They contend that, if the ten percent excise tax on late funding of pension obligations under Section

[5] Respondent did not raise this contention in the bankruptcy or district court. When it was raised for the first time in the court of appeals, the court did not address it.

4971(a) qualifies for priority as an "excise tax," then the 100 percent tax that is imposed under Section 4971(b) of the Internal Revenue Code would also be entitled to the same priority. The latter provision imposes a tax of 100 percent of the amount of an unfulfilled funding obligation that has not been corrected by the end of a statutory period that may be extended or waived. 26 U.S.C. 4971(b); see 26 U.S.C. 4961(a), 4963(e)(1)(B). Respondents assert that, if the 100 percent tax for uncorrected funding deficiencies under Section 4971(b) is entitled to priority as an "excise tax," it would be impossible for employers who consistently fail to meet their pension obligations to reorganize in bankruptcy (Resp. Br. 38-39; see also Resp. Br. 9, 12, 27).

The complicated and far-ranging set of issues that respondents thus seek to raise are not presented in this case:

(i) In the first place, the question of what bankruptcy priority would apply to the 100 percent tax for uncorrected funding deficiencies is not presented in this case because it is not raised here. The government's claim for this 100 percent tax was disallowed—not subordinated—by the bankruptcy court, and that ruling was not appealed. The claim was disallowed on the theory that the debtor's failure to cure the funding deficiency occurred *after* the petition was filed, at a time when the court believed respondents to be legally disabled from paying any prepetition debts (Pet. App. 54a).[6] Whether a debtor may legally make

[6] The district court similarly held that respondents' failure to make postpetition contributions to its underfunded pension plans was excused. *PBGC* v. *Reorganized CF&I Fabricators, Inc.*, 179 B.R. 704, 708 (D. Utah 1994). Other courts, however,

pension contributions after the date of the petition in bankruptcy is a controversial issue that is not now before the Court. See note 6, *supra*.[7]

By contrast, the missed contribution that gave rise to the ten percent excise tax under Section 4971(a) that *is* at issue in this case was due *before* the commencement of this bankruptcy case (Resp. Br. 2). Nothing in bankruptcy law prohibited respondents from making that pre-filing contribution on a timely basis. The bankruptcy court therefore properly allowed the Section 4971(a) excise tax claim, and it is the priority of *that* claim that is at issue in this case.

(ii) Respondents' suggestion (Resp. Br. 38-39) that an employer that cannot meet its pension plan obligations could not successfully reorganize fails to take account of the direct relief that is available to such an employer under ERISA. An employer experiencing temporary difficulty in making pension contributions may apply to the Secretary of the Treasury for a waiver of that year's funding obligation upon a showing of "temporary substantial busi-

have held that funding contributions due during a Chapter 11 reorganization are to be paid as postpetition administrative expenses with a "[f]irst" priority under 11 U.S.C. 507(a)(1). See, *e.g.*, *Columbia Packing Co.* v. *PBGC*, 81 B.R. 205, 209-210 (D. Mass. 1988) (pension contributions are properly viewed as "an ongoing, current cost of labor"); *In re Pacific Far East Line, Inc.*, 713 F.2d 476, 479-480 (9th Cir. 1983) (same under former Bankruptcy Act). If the latter view prevails, postpetition funding contributions may be made in future bankruptcies and the taxes imposed by Section 4971(b) thereby avoided.

[7] Moreover, the "excise tax" priority of Section 507(a)(7)(E) expressly applies only to prepetition excise tax claims (see 11 U.S.C. 507(a)(7)(E)). That priority is thus not applicable in determing the proper treatment of postpetition claims under Section 4971(b) of the Internal Revenue Code.

ness hardship." 26 U.S.C. 412(d)(1). If the difficulty is more than temporary, a debtor may terminate its pension plan in a "distress termination" if it can demonstrate to the bankruptcy court that it will not otherwise be able to reorganize. 29 U.S.C. 1341(c)(2)(B)(ii).[8] If the court approves termination of the plan, the employer's obligation to make future funding contributions is thereby terminated. See Rev. Rul. 79-237, 1979-2 C.B. 190. In this case, it was respondents' inaction that caused its obligation to make pension contributions to continue to accrue long after the bankruptcy case was commenced. Respondents did not take appropriate steps available under ERISA and the Bankruptcy Code to limit their pension liability.[9]

[8] In fashioning this test, Congress "tried to balance the need to limit access to the [plan termination] insurance system to cases of genuine need against the danger of making the tests so stringent that nothing short of total liquidation would qualify for PBGC assistance." H.R. Rep. No. 241, 99th Cong., 1st Sess., Pt. 2, at 49 (1985).

[9] Respondents seek to excuse this inaction by noting that they asked the PBGC to terminate the plan "unilaterally" (Resp. Br. 3 n.4). The authority of PBGC to terminate a plan is designed "to protect the interests of the participants" and to avoid increases "in the liabiliity of the [PBGC]." 29 U.S.C. 1342(c). That authority is not intended as a mechanism for the debtor to abandon the obligations of its collective bargaining agreement with the employees. If termination of the pension plan was essential to the reorganization but was not permitted under the collective bargáining agreement (see 29 U.S.C. 1341(a)(3)), respondents could have applied to the bankruptcy court under 11 U.S.C. 1113 for relief from the collective bargaining agreement. Respondents complain that such measures are time-consuming (Resp. Br. 39). But the Bankruptcy Code assures an employer a prompt hearing and ruling on an application to reject a collective bargaining agreement. See 11

(iii) Finally, we do not contend that the answer to the question that *is* presented in this case would also resolve whether a prepetition liability for the 100 percent tax imposed under Section 4971(b) is within the "excise tax" priority of Section 507(a)(7)(E) of the Bankruptcy Code. A determination that the ten percent excise tax imposed under Section 4971(a) is entitled to priority under Section 507(a)(7)(E) does not necessarily mean that the 100 percent tax imposed under Section 4971(b) is entitled to the same priority.

There are several distinctions between these two subsections. For example, the Secretary of the Treasury may, in "appropriate cases," waive imposition of the 100 percent tax under Section 4971(b) but has no authority to waive the ten percent tax under Section 4971(a). Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat., 997, § 3002(b); see 26 U.S.C. 4971(g) (cross reference).[10] The Secretary is also authorized to reduce the employer's funding requirement (26 U.S.C. 412(d)) and then abate the 100 percent tax (26 U.S.C. 4961(a)).[11] Whether

U.S.C. 1113(d) (requiring the bankruptcy court to schedule a hearing within 14 days after the commencement of the hearing, with only one seven-day extension permitted absent an agreement of the parties).

[10] See also H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 292 (1974) ("[t]he Service will be able to waive (or abate) the second level, but not the first level, tax upon a correction of underfunding that is obtained by the Secretary of Labor").

[11] By contrast, the ten percent excise tax imposed by Section 4971(a) is not subject to abatement even if "reasonable cause" for the failure to pay exists (26 U.S.C. 4962(a)(1)). See Section 4962(b) (making that standard applicable only to taxes imposed under 26 U.S.C. 4940-4948 and 26 U.S.C. 4955).

these and other distinctions between the fixed excise tax imposed under Section 4971(a) and the waivable tax imposed under Section 4971(b) are instrumental in application of the priority established in Section 507(a)(7)(E) of the Bankruptcy Code is an issue that is not presented in this case and that the Court need not address.

2. If the Court agrees that the excise tax imposed by Section 4971(a) is entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code, the second question presented in this case need not be addressed. Respondents do not contend that, if the government's claim is entitled to a statutory priority, it may then be subordinated under the "principles of equitable subordination" codified in Section 510(c) of the Bankruptcy Code.[12]

a. The second question presented in this case is whether, if the claim for the Section 4971(a) excise tax is *not* entitled to a statutory priority, it may be subordinated to other nonpriority unsecured claims under the "principles of equitable subordination" that Congress codified in Section 510(c) of the Bankruptcy Code. Relying exclusively on "principles of equitable subordination," the courts below approved a plan of reorganization that places the Section 4971(a) excise tax claim in a subordinated class and then further provides that, if the government's claim "should not be subordinated, such Claim shall be treated in [the class for nonsubordinated general unsecured claims]" (CF&I R. 141; see Resp. Br. 11). If the Section 4971(a) claim in this case is *not* entitled to a statutory

[12] A contention of that nature is addressed in *United States* v. *Noland*, No. 95-323, which is set for argument in tandem with this case.

priority, its treatment is thus entirely dependent on whether the claim is to be subordinated under the "principles of equitable subordination" in Section 510(c) of the Bankruptcy Code.

Respondents nonetheless attempt to raise several new arguments at this late stage of the case—arguments that have nothing to do with equitable subordination or with the question presented on the writ of certiorari. Respondents claim that it was unnecessary for the courts below to rely on the "principles of equitable subordination" under Section 510(c) to subordinate the government's claim (although respondents asked them to) because, under respondents' new arguments, subordination of the government's claim would be permitted under other provisions of the Bankruptcy Code (Resp. Br. 40-44).[13]

[13] Respondents state (Resp. Br. 42) that Section 1122(a) of the Bankruptcy Code requires that the Section 4971(a) claim be classified separately from other general unsecured claims because it is not "substantially similar" to such claims. See 11 U.S.C. 1122(a). They assert that general unsecured claims "represent a pecuniary loss" while the Section 4971(a) claim does not. But the presence or absence of "pecuniary loss" does not distinguish the Section 4971(a) claim from other general unsecured claims. For example, the expectancy component of a claim for damages for breach of contract (as contrasted with a recovery of out-of-pocket losses) is also not a pecuniary loss resulting from an extension of credit, but it has not been suggested that judgments for such damages are not "substantially similar" to other unsecured claims. The requirement that claims in the same class be "substantially similar" relates to more basic considerations, such as as placing secured claims, priority claims and unsecured claims in different classes. See 5 *Collier on Bankruptcy* ¶ 1122.03, at 1122-8 (15th ed. 1995).

Respondents also raise the new contention (Resp. Br. 40-41) that subordination of the Section 4971(a) claim is permitted

The contentions that respondents now seek to raise were not raised in the bankruptcy court or the district court and, although at least some of them

by Section 1129(a)(7) of the Bankruptcy Code, 11 U.S.C. 1129(a)(7). That Section requires the bankruptcy court to find that *non*assenting claimholders will fare at least as well under the reorganization plan as they would in a liquidation under Chapter 7 of the Bankruptcy Code. See 11 U.S.C. 1129(a)(7)(i), (ii). Since nonpecuniary loss penalty claims are automatically subordinated in Chapter 7 cases (11 U.S.C. 726(a)(4)), respondents assert that they had a right to insist that, if the Section 4971(a) excise tax is not a priority claim, it be subordinated to the claims of competing general unsecured creditors in this Chapter 11 reorganization. That interpretation of Section 1129(a)(7) has been rejected in numerous cases. See, *e.g.*, *In re Virtual Network Services Corp.*, 98 B.R. 343, 344 (N.D. Ill. 1989), aff'd on other grounds, 902 F.2d 1246 (7th Cir. 1990); *In re A.H. Robins Co.*, 89 B.R. 555, 560 (E.D. Va. 1988). But even if respondents' interpretation of Section 1129(a)(7) were correct, the statute would nonetheless be irrelevant to this case because respondents did *not* dissent from the plan (instead, they proposed it), and the plan as confirmed provides for treatment of the Section 4971(a) claim as a general unsecured claim (i) if the Section 4971(a) claim is not a priority claim and (ii) if that claim is not subject to equitable subordination under Section 510(c). See page 14, *supra*. Whatever effect Section 1129(a)(7) may have, it expressly does not apply to creditors that have "accepted the plan" (11 U.S.C. 1129(a)(7)(i)). If the holder of an impaired claim does not dissent from the plan on this basis, it therefore cannot thereafter attack it on this basis.

There are numerous reasons why a creditor would not dissent from a plan that leads to a reorganization under Chapter 11 rather than a liquidation under Chapter 7. Section 1129(a)(7) does not require creditors to insist upon Chapter 7 liquidation if they choose instead to assent to a Chapter 11 plan.

were raised in the court of appeals, were not addressed by that court.[14]

The courts below confirmed respondents' plan solely on the premise that the Section 4971(a) claim is to be subordinated to general unsecured claims "under principles of equitable subordination" (Pet. App. 18a, 21a). Because the new contentions that respondents advance in this Court were not raised in, addressed by, or resolved by the courts below, and are not within the scope of the question presented in the writ of certiorari, they are not properly before the Court. See, *e.g.*, *Yee* v. *Escondido*, 503 U.S. 519, 533 (1992); *Youakim* v. *Miller*, 425 U.S. 231, 234 (1976)

[14] Respondents contend that there is no statutory "category" of claims that encompasses general unsecured claims and that courts therefore need not rely on "principles of equitable subordination" to treat claims within that group differently (Resp. Br. 42). But "[t]he general rule * * * is that 'all creditors of equal rank with claims against the same property should be placed in the same class.'" *Granada Wines, Inc.* v. *New England Teamsters and Trucking Industry Pension Fund*, 748 F.2d 42, 46 (1st Cir. 1984) (citations omitted). Each unsecured nonpriority claim therefore "should be treated like any other unsecured claim" (*id.* at 47). See *In re Los Angeles Land and Investments, Ltd.*, 282 F. Supp. 448, 454 (D. Haw. 1968), citing 6A *Collier on Bankruptcy* § 9.13(1), at 238 (14th ed. 1940); *In re Barney & Carey Co.*, 170 B.R. 17, 22 (Bankr. D. Mass. 1994). But see *In re U.S. Truck Co.*, 800 F.2d 581, 587 (6th Cir. 1986).

As this Court has explained, the principle of "[e]quality of distribution among creditors" is that "creditors of equal priority should receive pro rata shares" (*Begier* v. *IRS*, 496 U.S. 53, 58 (1990)). A court is not to "set up a subclassification of claims within a class given equal priority * * * and fix an order of priority for the sub-classes according to its theory of equity." *In re Columbia Ribbon Co.*, 117 F.2d 999, 1002 (3d Cir. 1941).

("Ordinarily, this Court does not decide questions not raised or resolved in the lower court.").

b. Turning at last to the contentions that *were* raised and addressed below, respondents argue that the decisions of this Court do not expressly require creditor misconduct as a prerequisite to application of the doctrine of equitable subordination (Resp. Br. 44-48).[15] As this Court summarized in *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211 (1948), however, the doctrine of equitable subordination serves the narrow function of punishing creditors who engage in inequitable misconduct, by "depriv[ing] the wrongdoer of the fruits of his wrong." *Id.* at 229. It is undisputed that "there [has] been no inequitable conduct on the part of the [United States]" in this case (Pet. App. 6a). The doctrine of equitable subordination therefore simply does not apply.

[15] Respondents claim (Resp. Br. 44, 47, 48) that Section 502(j) of the Bankruptcy Code justifies subordination of a claim solely because of the "equities" of the case. That contention is not correct. Section 502(j) is a means of obtaining relief from a prior determination of the status of a claim when "the equities of the case" justify *reconsideration*. See 11 U.S.C. 502(j). Section 502(j) simply allows a court to reconsider the allowance or disallowance of a claim if reconsideration would be appropriate. See 3 *Collier on Bankruptcy* ¶ 502.10, at 502-107 to 507-108 (15th ed. 1995). Motions for reconsideration under Section 502(j) are analogous to motions under Federal Rules of Bankruptcy Procedure 9023 and 9024, which make Rules 59 and 60 of the Federal Rules of Civil Procedure applicable in bankruptcy cases. See *Colley* v. *National Bank*, 814 F.2d 1008, 1010 (5th Cir.), cert. denied, 484 U.S. 898 (1987); *S.G. Wilson Co.* v. *Cleanmaster Industries, Inc.*, 106 B.R. 628, 630 (Bankr. 9th Cir. 1989); *In re Stoecker*, 151 B.R. 989, 1001 (Bankr. N.D. Ill. 1993).

As we explain in detail in our opening brief in this case (Pet. Br. 21-30)—and in the opening and reply briefs in *United States* v. *Noland*, No. 95-323, which is being argued in tandem with this case—the requirement of creditor misconduct was a well established principle of equitable subordination when Congress codified those principles in Section 510(c) of the current Bankruptcy Code.[16] Respondents claim, however, that a different understanding of the statute is compelled by the statement of Representative Edwards that, "under existing law, a claim is generally subordinated only if [the] holder of such claim is guilty of inequitable conduct, or the claim itself is of a status susceptible to subordination, such as a penalty." 124 Cong. Rec. 32,398 (1978).

As a description of "existing law," the floor statement is simply incorrect, a fact that is confirmed by respondents' failure to identify a single case in which penalties were subordinated prior to enactment of the Bankruptcy Code in 1978.[17] Any misdescription of

[16] Respondents erroneously imply (Resp. Br. 45 n.31) that *In re Stirling Homex Corp.*, 579 F.2d 206 (2d Cir. 1978), and *In re Four Seasons Nursing Ctrs. of America, Inc.*, 472 F.2d 747 (10th Cir. 1973), represent pre-Bankruptcy Code applications of principles of equitable subordination in the absence of creditor misconduct. Neither case is an example of equitable subordination. Instead, both are examples of the fundamental bankruptcy rule that the claims of creditors are to be paid ahead of the interests of shareholders. See Pet. Br. 26-28 in *United States* v. *Noland*, No. 95-323. See also 472 F.2d at 749-750.

[17] As we describe in detail in our reply brief in *United States* v. *Noland*, No. 95-323 (at 5 n.2), prepetition nonpecuniary-loss penalty claims were disallowed prior to enactment of the Bankruptcy Code (see 11 U.S.C. 93(j) (1976)). Post-petition penalties were then, as now, given first priority (*Nicolas* v. *United States*, 384 U.S. 678, 694-695 (1966)). But no penalties

"existing case law" in the 1978 floor statement of Representative Edwards obviously does not alter the preexisting "principles of equitable subordination" that are to be applied under Section 510(c). *Burden* v. *United States*, 917 F.2d 115, 123 (3d Cir. 1990) (Alito, J., concurring in part and dissenting in part). Moreover, the Senate Report on the provision that was enacted as Section 510(c) accurately described its effect (S. Rep. No. 989, 95th Cong., 2d Sess. 74 (1978) (emphasis added)):

> "[A]ny subordination under this provision must be based on principles of equitable subordination. These principles are defined by case law, and have generally indicated that *a claim may normally be subordinated only if its holder is guilty of misconduct.*

The doctrine of equitable subordination permits courts to punish misconduct; it does not permit courts to alter the priorities that Congress established for innocent claimants. It therefore does not permit subordination of the innocent claim of the United States to the claims of other unsecured general creditors in this case.

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were subject to subordination (in the absence of creditor misconduct) under the judge-made "principles of equitable subordination" that Congress codified as Section 510(c) of the Bankruptcy Code.

For the foregoing reasons and the reasons set forth in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

MARCH 1996

(5)

No. 95-325

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

UNITED STATES OF AMERICA,
Petitioner,

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC.,
et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF OF THE PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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BRIEF OF THE PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF THE AMICUS CURIAE

The Pension Benefit Guaranty Corporation ("PBGC") is a wholly-owned United States government corporation, 29 U.S.C. § 1302, modeled after the Federal Deposit Insurance Corporation, 120 Cong. Rec. 29950 (1974) (statement of Sen. Bentsen). PBGC guarantees the payment of nonforfeitable benefits in defined benefit pension plans

sponsored by private businesses. *See generally PBGC v. LTV Corp.*, 496 U.S. 633 (1990); *Nachman Corp. v. PBGC*, 446 U.S. 359 (1980).[1]

This case involves the treatment in bankruptcy of excise taxes that Congress imposed to encourage companies to fund the pension plans insured by PBGC. Respondents have asserted and the courts below assumed that a decision in favor of the Internal Revenue Service would be harmful to PBGC because it would diminish the funds available for distribution to PBGC in this case. That is not PBGC's view. PBGC believes that a decision in favor of the IRS would greatly benefit PBGC's insurance program because it would establish unequivocally that employers must fund their pension plans regardless of bankruptcy. It would thus have an extremely beneficial effect on pension funding in other plans and therefore, in the long run, on PBGC's financial health. For the same reason, it would benefit millions of participants in other pension plans whose pensions PBGC protects.

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[1] PBGC, "an agency of the United States authorized by law to appear on its own behalf," files this brief *amicus curiae* pursuant to Rule 37.5 of this Court's rules. *See* 29 U.S.C. § 1302(b)(1) (PBGC has the power "to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any court, State or Federal"). PBGC has appeared in this Court through its own counsel both as a party, *see, e.g.*, *LTV*, 496 U.S. 633; *Nachman*, 446 U.S. 359, and as an *amicus curiae*, *see, e.g.*, *Concrete Pipe & Prods. of California, Inc. v. Construction Laborers Pension Trust*, 113 S. Ct. 2264, 2278 (1993); *Commissioner v. Keystone Consol. Indus.*, 113 S. Ct. 2006, 2013 n.3 (1993); *Mead Corp. v. Tilley*, 490 U.S. 714, 722, 726 (1989).

Besides its concern with pension funding, PBGC has an interest in the principles of law applied to determine the priority of tax claims in bankruptcy. The event that usually necessitates a PBGC takeover of a pension plan is the bankruptcy of the company sponsoring the plan. PBGC files claims as federal guarantor for the overall funding shortfall and, in its separate capacity as statutory trustee, for employer contributions owed to the plan. *See* 29 U.S.C. § 1362. PBGC asserts that portions of its claims are entitled to first priority as post-petition taxes or seventh priority as pre-petition excise taxes. Thus, the proper construction of the provisions of the Bankruptcy Code governing tax priority is of great concern to PBGC.

Respondents' assertion that a decision in favor of the IRS would be harmful to PBGC is premised in part on their assumption that PBGC's bankruptcy claims are general unsecured claims not entitled to priority. Respondents' Brief in Opposition to the Petition for a Writ of Certiorari at 3, 5. Although the bankruptcy court and the district court in this case have denied priority to most of PBGC's claims, *see PBGC v. Reorganized CF&I Fabricators, Inc. (In re CF&I Fabricators, Inc.)*, 179 B.R. 704 (D. Utah 1994), those decisions are not final; PBGC expects to appeal once there is a final order. An accurate description of the status of PBGC's claims may provide the Court a better understanding of the instant controversy.

Finally, as a major creditor in many bankruptcies, PBGC is concerned about the unfettered discretion that the court of appeals' decision would bestow upon the bankruptcy courts to subordinate the claims of innocent creditors based

on "equitable" considerations. Such wide-ranging discretion, never contemplated by Congress, could be used to deprive unpopular claimants of their statutory share of a bankrupt's assets.

STATEMENT OF THE CASE

PBGC relies principally on the Statement in the Brief for the United States.[2] Some additional background is provided below.

A. ERISA's Minimum Funding Requirements

The pension plans at issue in this case are defined benefit pension plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), *codified in* 29 U.S.C. §§ 1001-1461 (1994) *and various provisions of* Title 26 U.S.C.[3] One of Congress's central purposes in enacting ERISA was to ensure "that if a worker has been promised a defined pension benefit upon retirement -- and if he has fulfilled whatever conditions are required to obtain a vested benefit -- he actually will receive it." *Nachman*, 446 U.S. at 375. As this Court explained in *Nachman*, Congress adopted several strategies to achieve that goal. One was to provide for "a minimum funding schedule and

[2] PBGC did not participate in this dispute in the courts below.

[3] A "defined benefit" pension plan, sometimes referred to as a "traditional" pension plan, is one that promises employees a fixed retirement benefit based on such factors as final salary and years of service with the employer. *See* 29 U.S.C. § 1002(34) and (35); *Keystone Consol. Indus.*, 113 S. Ct. at 2009.

prescribed standards of conduct for plan administrators to make as certain as possible that pension fund assets would be adequate." *Id.* Another was to create PBGC to guarantee benefits in the event that "a plan nonetheless terminates without sufficient assets to pay all vested benefits." *Id.*

The minimum funding standards are set forth in section 412 of the Internal Revenue Code, 26 U.S.C. § 412.[4] Each plan must establish a "funding standard account" to which various charges and credits are made each year. 26 U.S.C. § 412(b). If sufficient contributions are not made in a given year to bring the funding standard account to zero or higher, the plan has an "accumulated funding deficiency" for that year and does not satisfy the minimum funding standard. 26 U.S.C. § 412(a).

Congress put teeth into ERISA's minimum funding requirements by enacting section 4971 of the Internal Revenue Code, 26 U.S.C. § 4971. That section imposes a tax of ten percent on any accumulated funding deficiency,[5] with an additional tax if the deficiency is not corrected.

[4] Many of the provisions of ERISA, including the minimum funding rules, are both codified in Title 29 of the United States Code and incorporated into the Internal Revenue Code. *Compare, e.g.*, 29 U.S.C. § 1082 *with* 26 U.S.C. § 412.

[5] The tax was originally five percent but was increased to ten percent in 1987. Pension Protection Act, Pub. L. No. 100-203, § 9304, 101 Stat. 1330-333, 1330-348 (1987). Because the ten percent rate applies to this case, we refer throughout this brief to the "ten percent" tax.

B. The PBGC Insurance Program

In Title IV of ERISA, Congress established a mandatory termination insurance program administered by PBGC. 29 U.S.C. §§ 1301-1461. In the event that, notwithstanding the minimum funding requirements, a pension plan terminates without enough assets to pay promised benefits, PBGC's insurance program provides a safety net. *See Nachman*, 446 U.S. at 375. When an underfunded plan terminates, PBGC takes over the assets of the plan and pays the nonforfeitable benefits, up to statutory limits. *See* 29 U.S.C. §§ 1322, 1342, 1361.

PBGC pays guaranteed benefits primarily from insurance premiums paid to PBGC by employers that sponsor covered pension plans, 29 U.S.C. §§ 1306-07, but also from amounts it collects from the employers whose pension plans have terminated, 29 U.S.C. § 1362. When an underfunded plan terminates, the employer becomes liable to PBGC for the "total amount of the unfunded benefit liabilities" of the plan. 29 U.S.C. § 1362(a), (b).[6]

This liability is intended to reimburse PBGC for at least a portion of the benefits it pays under a terminated plan. *See*

[6] The unfunded benefit liabilities represent the total shortfall in a plan's assets to pay promised benefits. *See* 29 U.S.C. § 1301(a)(18). A plan may have a shortfall even if all minimum funding contributions have been made because the funding rules allow the benefit liabilities to be funded over a period of years. *See* 26 U.S.C. § 412(b)(2)(B).

LTV, 496 U.S. at 638.[7] If the employer is in bankruptcy, PBGC asserts a tax priority claim for all or part of this liability pursuant to 29 U.S.C. § 1362. *See also* 29 U.S.C. § 1368.[8]

C. Facts and Proceedings

CF&I Steel Corporation ("CF&I") was the sponsor of two defined benefit pension plans covered by PBGC. The larger of the two plans was underfunded by more than $200 million by 1990.

For the year ended December 31, 1989, CF&I owed contributions of $12.4 million to the pension plans, almost all of which was owed to the larger plan.[9] The "immediate

[7] PBGC pays benefits up to the statutorily guaranteed level regardless of whether it recovers anything from the employer. *See* 29 U.S.C. §§ 1322, 1361.

[8] As statutory trustee of a terminated pension plan, PBGC is also empowered to collect unpaid contributions owed to the plan. 29 U.S.C. §§ 1342(d)(1)(B)(ii), 1362(c). Where a bankrupt company has missed contributions exceeding $1 million, PBGC asserts tax priority for this claim based on 26 U.S.C. § 412(n)(1), (n)(4)(C) (imposing a lien for the missed contributions and providing that "[a]ny amount with respect to which a lien is imposed" is "treated as taxes due and owing the United States").

[9] The smaller plan was eventually terminated in a "standard termination" under 29 U.S.C. § 1341(b), which meant that plan assets were sufficient to provide all promised benefits. Although the excise taxes here applied to both plans, for convenience we refer hereafter only to the "plan."

cause" of the Chapter 11 filings was the companies' inability to fund the pension plan.[10]

During the reorganization proceeding, CF&I neither made any contributions to the pension plan nor took any steps to terminate it. Because the plan was paying substantial benefits but receiving no contributions, its assets were being depleted. Faced with mounting losses, PBGC initiated an involuntary termination of the plan under 29 U.S.C. § 1342(c). The plan was terminated on March 19, 1992, and PBGC became its statutory trustee.

PBGC asserted a claim against CF&I for approximately $223 million in unfunded benefit liabilities, making PBGC one of the largest creditors in the bankruptcy. PBGC asserted that a portion of this claim was entitled to first priority as an administrative tax under sections 503(b)(1)(B) and 507(a)(1) of the Bankruptcy Code, 11 U.S.C. §§ 503(b)(1)(B), 507(a)(1). In the alternative, PBGC contended that this portion should be accorded seventh priority as an excise tax under 11 U.S.C. § 507(a)(7).

The bankruptcy court denied priority to the unfunded benefit liabilities claim. The district court affirmed, but remanded to the bankruptcy court to resolve a dispute about the amount of the claim. *Reorganized CF&I Fabricators,*

[10] Disclosure Statement for Debtors' and Railroad Trustee's First Amended and Restated Plan of Reorganization Dated December 1, 1992, Exhibit 6 at 1-2, *In re CF&I Fabricators of Utah, Inc.*, No. 90B-6721 (Bankr. D. Utah).

179 B.R. 704. PBGC expects to appeal that ruling once a final order is issued by the district court.[11]

The Internal Revenue Service also filed proofs of claim against CF&I. These included claims for the ten percent tax under section 4971(a) of the Internal Revenue Code on the $12.4 million of minimum funding contributions CF&I failed to make for 1989. The facts and proceedings relating to those claims are described in the Brief for the United States.

SUMMARY OF THE ARGUMENT

This case involves the construction of two federal statutes. In 1974, as part of ERISA, Congress imposed a tax on an employer's failure to make required contributions to its pension plan. 26 U.S.C. § 4971(a). In 1978, in revising the federal bankruptcy law, Congress provided that "excise tax[es]" should be accorded priority in the hierarchy of creditor claims. 11 U.S.C. § 507(a)(6)(E) (1982). The first question before the Court is whether the tax on missed pension contributions is an excise tax entitled to this bankruptcy priority.

This question must be answered in the affirmative. Congress labeled this exaction a "tax," and there are compelling reasons to conclude that it must be an excise tax.

[11] PBGC also asserted claims on behalf of the pension plan for $71 million in unpaid minimum funding contributions. The bankruptcy court and the district court denied priority status to all but a small portion of these claims as well. PBGC expects to appeal these rulings along with the denial of priority to its claim for unfunded benefit liabilities.

"Excise tax" has always been construed as a broad, residual category that includes any kind of tax that is not a direct tax on persons or property. The history of the 1978 Bankruptcy Code indicates that Congress intended to use it in this broad manner. Moreover, the legislative history of ERISA makes clear that Congress understood this exaction on missed pension contributions to be an excise tax.

The court of appeals erred in disregarding these plain manifestations of congressional intent. Instead, the court applied a four-part test formulated in *County Sanitation District No. 2 of Los Angeles County v. Lorber Industries of California, Inc. (In re Lorber Industries of California, Inc.)*, 675 F.2d 1062, 1066 (9th Cir. 1982). That test, and its antecedents in this Court's opinions, are appropriately applied to determine if a state exaction is a tax for bankruptcy purposes or if a federal exaction is such a tax where congressional intent is not explicit. It has no application in a case like this where the congressional intent is clear that the exaction is a tax.

The court of appeals also erred in subordinating the IRS tax claim under authority of 11 U.S.C. § 510(c)(1). That provision was intended to allow "equitable subordination" of a claim only where the claimant has engaged in some misconduct, which concededly is not the case here. The court of appeals' ruling would permit bankruptcy judges to disregard the detailed statutory scheme for allocation of a debtor's assets and instead allocate assets based on their own opinions about what is "equitable."

In their rulings, the lower courts relied in part on a misperception of the interests of PBGC. The courts thought that denying priority to the IRS claim and subordinating it would benefit PBGC inasmuch as PBGC is one of the largest creditors in the CF&I bankruptcy. This is too narrow a view. According priority to the IRS claim will strengthen PBGC's insurance program by helping to ensure that companies fund their pension plans in compliance with ERISA.

ARGUMENT

I. THE SECTION 4971(a) EXACTION IS A TAX ENTITLED TO PRIORITY AS AN EXCISE.

A. The Bankruptcy Code Accords Priority to All Taxes, Subject Only to Specified Time Limitations.

Taxes have long been granted priority treatment in bankruptcy. Under Section 64 of the former Bankruptcy Act, all post-petition taxes incurred by the estate were treated as "costs and expenses of administration" entitled to the highest priority. 11 U.S.C. § 104(a) (1964). All pre-petition taxes "legally due and owing" were accorded fourth priority, and the courts developed various rules to determine precisely when various types of taxes became "legally due and owing." 11 U.S.C. § 104(a)(4); *see generally* William T. Plumb, Jr., *The Tax Recommendations of the Commission on the Bankruptcy Laws -- Priority and Discharge of Tax Claims*, 59 Cornell L. Rev. 991, 1008-11 (1974). In 1966, Congress amended section 64 to limit priority treatment to

taxes that became "legally due and owing" within the three years before the bankruptcy petition.[12] Thus, under the law as it stood before 1978, all *kinds* of taxes were entitled to priority, but a particular tax claim would not receive priority if it were more than three years "old."

In the Bankruptcy Code of 1978, Congress retained the concept that all taxes would be given priority but modified and made more specific the "staleness" rules governing which taxes were too old to receive priority. Congress thus retained first priority for all post-petition taxes incurred by the bankruptcy estate. 11 U.S.C. §§ 503(b)(1)(B), 507(a)(1). For pre-petition taxes, Congress continued to accord a lower priority[13] but adopted a different approach for determining staleness. Rather than apply a three-year limit to all pre-petition taxes subject to judge-made rules regarding when the tax became "legally due and owing," Congress listed the various kinds of taxes and applied a different time limitation to each. *See* 11 U.S.C. § 507(a)(7). Among the taxes listed were income taxes, property taxes,

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[12] Pub. L. No. 89-496, 80 Stat. 271 (1966). Fourth priority was limited to those taxes "which are not released by a discharge in bankruptcy," 11 U.S.C. § 104(a)(4) (1970), and taxes exempt from discharge included those "which became legally due and owing within three years preceding bankruptcy," 11 U.S.C. § 35 (1970).

[13] Pre-petition taxes were given sixth priority in the 1978 enactment. 11 U.S.C. § 507(a)(6) (1982). Section 507(a) has been amended twice since then to include additional categories of priority claims payable before pre-petition taxes. Pre-petition taxes thus currently receive eighth priority. 11 U.S.C. § 507(a)(8). Because the priority for pre-petition taxes was seventh at all times relevant to this case, we refer to it herein as "seventh" priority and cite to it as 11 U.S.C. § 507(a)(7).

taxes required to be collected or withheld ("trust-fund" taxes), employment taxes on wages or salary, customs duties on imported goods, and "excise tax[es]." *Id.*

The new time limitations on each of these kinds of taxes both specified the number of years in the "look-back" period and the manner in which the period would be measured. *See id.*; *Green v. Beaman (In re Beaman)*, 9 B.R. 539, 541 (Bankr. D. Ore. 1980) ("Congress sought to enumerate types of taxes for the purpose of setting a time under which each tax would become stale and dischargeable").[14] Thus, for example, property taxes receive priority only if they were last payable without penalty during the year immediately before the bankruptcy filing. 11 U.S.C. § 507(a)(7)(B). Income taxes, on the other hand, are entitled to priority if they were last due during the three years before the bankruptcy. 11 U.S.C. § 507(a)(7)(A). Excise taxes likewise are subject to a three-year staleness rule.[15]

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[14] *See also Report of Commission on the Bankruptcy Laws of the United States ("Bankruptcy Commission Report")*, H.R. Doc. No. 137, Part I, 93d Cong., 1st Sess. 215-16 (1973) (discussing origins of statutory language).

[15] Claims of governmental units are entitled to seventh priority to the extent such claims are for --

> an excise tax on --
>
> > (i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

Courts analyzing these changes to the structure of the bankruptcy laws have concluded that Congress did not intend to exclude any kinds of taxes from priority. The question, as one court put it, is --

> whether a change was wrought in the law, wittingly or unwittingly, by the Congress when it undertook to specify kinds of taxes entitled to priority, instead of the simple all-embracing statement about taxes which was employed in the Bankruptcy Act.

State of Ohio, Bureau of Workers' Compensation v. TRI-Mfg. & Sales Co. (In re TRI-Mfg. & Sales Co.), 82 B.R. 58, 60 (Bankr. S.D. Ohio 1988). The court answered the question in the negative. *Id.* The listing of taxes in section 507(a)(7) "was intended to be comprehensive and include all federal and state taxes." *Beaman*, 9 B.R. at 541; *see Bankruptcy Commission Report* at 215-16.

Thus, in determining whether an exaction is entitled to priority under section 507(a)(7), the first question is whether it is a tax. If so, the next question is what kind of tax it is. The answer to that question governs what staleness rule should be applied.

> (ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition.

11 U.S.C. § 507(a)(7)(E).

B. "Excise Tax" in Section 507(a)(7)(E) of the Bankruptcy Code Is a Broad, Residual Category.

"Excise tax" is the most inclusive of the categories of taxes enumerated in section 507(a)(7) and is properly viewed as a residual category. Historically, this Court has construed "excise tax" broadly. *See, e.g., Chas. C. Steward Machine Co. v. Davis*, 301 U.S. 548, 582 (1937); *Bromley v. McCaughn*, 280 U.S. 124, 137 (1929); *Springer v. United States*, 102 U.S. 586 (1881). That broad construction is informative, courts have held, in interpreting "excise tax" in section 507(a)(7)(E) of the Bankruptcy Code. *See Beaman*, 9 B.R. at 541; *United States v. King (In re King)*, 19 B.R. 936, 939 (Bankr. E.D. Tenn. 1982). "Congress' use of the broadly defined category of 'excise taxes' *was designed to include all indirect taxes not otherwise included in [§ 507(a)(7)].*" *Beaman*, 9 B.R. at 541 (emphasis added).[16]

The legislative history of the Bankruptcy Reform Act of 1978 confirms that "excise tax" must be read broadly. The joint floor statements provided:

> *All Federal, State, or local taxes generally considered or expressly treated as excises are covered by this category, including* sales taxes, estate and gift taxes, gasoline

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[16] *See also New Neighborhoods, Inc. v. West Virginia Workers' Compensation Fund*, 886 F.2d 714, 719 (4th Cir. 1989); *In re TRI-Mfg.*, 82 B.R. at 60; *In re King*, 19 B.R. at 939.

> and special fuel taxes, and wagering and truck taxes.

124 Cong. Rec. 32416 (1978) (Rep. Edwards) (emphasis added); *id.* at 33998, 34016 (Sen. DeConcini) (same).[17] The emphasized language indicates the breadth intended for this priority category. The examples cited, broad in themselves, are not exhaustive, as shown by the word "including." "All" taxes that are "generally considered or expressly treated" as excises come within this category.

C. The Section 4971(a) Exaction Is a "Tax" That Falls Within the Category of "Excise Tax" in Section 507(a)(7)(E).

Resolution of this case is straightforward. As explained above, the first question is whether the ten percent exaction under section 4971(a) is a "tax." On this point, there can be no doubt. Congress has called it a "tax" in the very section of the Internal Revenue Code that imposes it: "For each taxable year . . . there is hereby imposed a tax of 10 percent . . . ." 26 U.S.C. § 4971(a). As the Sixth Circuit pointed out in *United States v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.)*, 942 F.2d 1055, 1059-60 (6th Cir. 1991), *cert. denied*, 502 U.S. 1092 (1992), tests developed by this Court or other courts to determine whether

[17] Because the House and Senate did not hold a formal conference in enacting the Bankruptcy Reform Act of 1978, floor statements by Representative Edwards and his counterpart floor manager Senator DeConcini have been treated as "persuasive evidence of congressional intent." *Begier v. IRS*, 496 U.S. 53, 64 n.5 (1990).

a particular exaction should be viewed as a tax are not needed when Congress has expressly characterized the exaction as a tax. "We are unaware of any intent by Congress to have its *own* characterizations of payments as 'taxes' subject to second-guessing by the federal courts." *Id.* at 1060 (emphasis in original).

The second question is what category of tax is before the Court -- which staleness rule under section 507(a)(7) should be used? Here again, congressional intent is clear. Congress "expressly treated" the section 4971(a) tax on missed minimum funding contributions as an excise tax. The Conference Report accompanying the 1974 enactment of ERISA explicitly called this tax an "excise tax":

> If the minimum contributions have not been made, the funding standard account will show a deficiency (called an "accumulated funding deficiency"). If there is an accumulated funding deficiency, *an excise tax* is to be imposed on the employer who is responsible for making contributions to the plan. . . .

H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 284 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5065 (emphasis added).

As the Sixth Circuit did in *Mansfield Tire*, the court of appeals here should have given effect to the clear intent of Congress and held that the section 4971(a) exaction is a tax and, in particular, an excise tax.

Instead, the Tenth Circuit applied the four-part test developed in *Lorber*, 675 F.2d at 1066. *United States v. Reorganized CF&I Fabricators, Inc. (In re CF&I Fabricators, Inc.)*, 53 F.3d 1155, 1157-58 (10th Cir. 1995). The court of appeals agreed with the bankruptcy court that the section 4971(a) tax did not meet that test and therefore was not entitled to the priority for excise taxes. *Id.* at 1158 (citing *In re CF&I Fabricators, Inc.*, 148 B.R. 332 (Bankr. D. Utah 1992)).

The court of appeals erred in applying the *Lorber* test to this case. That test was formulated to determine whether a state exaction is a tax for federal bankruptcy purposes. It drew heavily upon this Court's decisions in *New York v. Feiring*, 313 U.S. 283 (1941), and *New Jersey v. Anderson*, 203 U.S. 483 (1906), both of which also involved whether a state exaction was entitled to bankruptcy priority as a tax.

The *Lorber* test, or the *Feiring* and *Anderson* principles from which it was derived, have also been applied to determine whether or not a federal exaction is a tax for bankruptcy purposes in cases where the congressional intent was not explicit. For example, in *United States v. New York*, 315 U.S. 510 (1942), this Court relied on *Feiring* and *Anderson* in holding a claim for taxes on employee income under the Social Security Act to be a priority tax even when assessed against the employer. Similarly, the *Lorber* test and/or the *Feiring/Anderson* criteria have been applied in concluding that "premiums" under the Coal Industry Retiree Health Benefit Act of 1992 were post-petition taxes entitled

to administrative priority[18] and that reclamation "fees" imposed pursuant to the Surface Mining Control and Reclamation Act of 1977 were excise taxes entitled to seventh priority.[19] PBGC has relied on *Feiring* and *Anderson* because its claim for unfunded benefit liabilities, although treated as a tax for enforcement purposes, *see* 29 U.S.C. § 1368, is not labeled a tax in the section imposing the liability, *see* 29 U.S.C. § 1362. In situations like these where the statutory language is ambiguous, analysis of the nature of the exactions is necessary.

In this case, however, the congressional intent to treat the exaction on missed minimum funding contributions as an excise tax is unmistakable. Hence, resort to *Lorber* or any similar test to determine the nature of the exaction is unnecessary and inappropriate.

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[18] *LTV Steel Co., Inc. v. Shalala (In re Chateaugay Corp.)*, 53 F.3d 478, 498 (2d Cir.), *cert. denied*, 116 S. Ct. 298 (1995).

[19] *United States v. Ringley*, 985 F.2d 185, 187-88 (4th Cir. 1993); *In re C.M. & C. Coal Co.*, 33 B.R. 358, 359-60 (Bankr. N.D. Ala. 1983); *In re King*, 19 B.R. at 938-39; *see also United States v. River Coal Co.*, 748 F.2d 1103, 1106 (6th Cir. 1984) (pre-petition tax under former Bankruptcy Act).

II. THE SECTION 4971(a) CLAIM MAY NOT BE SUBORDINATED ABSENT INEQUITABLE CONDUCT BY THE CLAIMANT.

The court of appeals not only denied priority to the IRS section 4971(a) excise tax claim, it also subordinated it to the claims of other unsecured creditors under "principles of equitable subordination" pursuant to section 510(c)(1) of the Bankruptcy Code, 11 U.S.C. § 510(c)(1). The court did so even though it found no misconduct by the government.

This holding was wrong, for the reasons stated in the Brief for the United States. The pension insurance system could be jeopardized by a rule that would allow bankruptcy judges virtually unlimited discretion to subordinate claims based on their subjective notions of what is "equitable." As it was in this bankruptcy, PBGC is often one of the largest creditors.[20] Hostility to such a large claimant, particularly a governmental entity like PBGC, is not uncommon. "Equitable subordination," if construed as the lower courts did here, could be used as a weapon against unpopular creditors.[21]

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[20] PBGC was either the largest creditor or one of the largest creditors in the bankruptcies of The LTV Corporation, Eastern Air Lines, Pan American World Airways, Wheeling-Pittsburgh Steel Corporation, Sharon Steel Corporation, and New Valley Corporation (formerly Western Union Corporation).

[21] For example, in one pending case, a bankruptcy trustee challenging PBGC's calculation of its claims has argued that the disputed portions -- amounting to millions of dollars -- should be equitably subordinated under 11 U.S.C. § 510(c)(1). *Belfance v. PBGC (In re CSC Industries, Inc.)*, Bankr. No. 93-41898, Adversary Proceeding No.

The use of equitable subordination to deal with entire categories of claims is inappropriate when Congress itself has decided how to allocate limited estate assets among various classes of innocent creditors. As the discussion above illustrates, Congress has taken great care to determine the order in which unsecured claims should be paid. In addition to establishing those payment priorities, Congress has required: that only "substantially similar" claims may be classed together in a plan of reorganization, 11 U.S.C. § 1122(a); that a plan of reorganization must provide "the same treatment" for each claim of a particular class, 11 U.S.C. § 1123(a)(4); and that junior classes may not receive a distribution under a reorganization plan unless senior classes have been paid in full, 11 U.S.C. § 1129(b)(2)(B)(ii). The lower courts' interpretation of equitable subordination would allow for judicial second-guessing of these congressional judgments as well as a reshuffling of the legislated priorities. That cannot be what Congress intended in enacting section 510(c)(1).

This Court should confine the doctrine of equitable subordination to its proper role as a tool to deal with misconduct by a creditor.

95-4103 (Bankr. N.D. Ohio).

III. GRANTING PRIORITY TO THE SECTION 4971(a) CLAIM WILL BENEFIT THE PENSION INSURANCE SYSTEM AND PENSION PLAN PARTICIPANTS.

In denying priority to and subordinating the IRS claims for the section 4971(a) excise tax, the courts below relied in part on the alleged harm contrary rulings would inflict on the pension insurance system and pension plan participants. The courts misperceived the interests of PBGC and participants and were thereby led astray.

In explaining why it was denying priority to the section 4971 claims, the bankruptcy court gave as its first reason the perceived anomaly of putting the IRS tax claim ahead of PBGC's claims:

> This court previously found that the claims of the PBGC for the underlying obligation are, for the most part, pre-petition unsecured claims. To allow priority treatment for alleged tax claims based on pension funding deficiencies, when the pension plan's claims do not receive such treatment, would elevate the section 4971 claims to a status ahead of those claims.

In re CF&I Fabricators, 148 B.R. at 339. The bankruptcy court also asserted that granting priority to the IRS claims "would harm the parties that are intended to be protected by the pension plan that section 4971 seeks to enforce, because payment of section 4971 penalty claims would be at the

expense of pre-petition unsecured creditors including pensioners." *Id.*

The court of appeals applied similar reasoning in its decision to subordinate the IRS claims. After noting that unsecured creditors would receive only a small percentage of their claims, the court stated:

> One of CF&I's unsecured creditors is the PBGC, which will be paying the pension benefits due under CF&I's terminated pension plan. Declining to subordinate the IRS's penalty claim would harm innocent creditors rather than punish the debtor for failing to fund the pension plan.

Reorganized CF&I Fabricators, 53 F.3d at 1159.

These statements assume that PBGC's claims are not entitled to priority. Although the bankruptcy court and the district court have so ruled, no final order has yet been issued and PBGC will vigorously seek reversal in the court of appeals. Portions of PBGC's claims could ultimately receive priority along with the IRS section 4971(a) claims.

More important, the lower courts have lost sight of the forest for the trees. PBGC's financial health will not be greatly affected by the size of its recovery in this case, regardless of the outcome of the litigation over its claims. What would make a major difference to PBGC would be compliance by employers with ERISA's minimum funding

standards. Inducing such compliance, of course, is the purpose behind the section 4971 excise taxes.

Congress has long recognized the effect on PBGC of the minimum funding standards. When ERISA was enacted, one of the principal Senate sponsors explained that the PBGC "termination insurance program is intended to work hand in hand with the minimum funding standards imposed by the bill, since the latter will limit the losses due to plan termination by requiring more adequate funding of pension plans." 120 Cong. Rec. 29952 (1974) (Sen. Nelson). Congress has tightened the funding requirements several times since ERISA was passed, with a view toward strengthening PBGC.[22]

Indeed, in 1987 Congress increased the section 4971(a) tax from five percent to ten percent in order to protect PBGC. At that time, Congress had before it a GAO report entitled *Pension Plans: Government Insurance Program Threatened By Its Growing Deficit*, GAO/HRD-87-42 (March 19, 1987), which stated that claims against PBGC resulted in large part because of the inadequacy of the then-existing funding standards. S. Finance Committee Print 100-63, 100th Cong., 1st Sess. 170 (1987). The Senate Finance Committee explained that, "in light of the GAO

[22] Pension Protection Act, *supra* note 5, §§ 9303-07, 101 Stat. 1330-333 to -359. Only a little over a year ago, Congress again tightened the minimum funding rules in the Retirement Protection Act of 1994, Pub. L. No. 103-465, §§ 751, 761, 108 Stat. 4809, 5012-22, 5024-34 (1994).

report," the increase in the section 4971(a) tax was needed to ensure that contributions are made when due. *Id.* at 180.

The section 4971 excise taxes are thus important to the well-being of the PBGC pension insurance program. Denying them priority or, worse, subordinating them to the claims of other unsecured creditors would greatly diminish their effectiveness. In PBGC's experience, employers whose pension plans are seriously underfunded are most likely to stop making minimum funding contributions just before entering bankruptcy. Often, they also fail to make pension contributions during bankruptcy proceedings. That is precisely what CF&I did in this case, even though it continued to make millions of dollars of payments during the bankruptcy for other employee benefits such as health and life insurance. Granting priority to the IRS excise taxes would provide a powerful incentive to such employers to stop treating their pension plans as an (involuntary) lender of last resort.[23]

The interests of pension plan participants must similarly be viewed from a wider angle than the courts below used. More than 41 million Americans are insured by PBGC in about 58,000 plans subject to ERISA's minimum funding standards. PBGC Annual Report to the Congress, inside cover (1994). The best protection for these workers and retirees also lies in compliance by their employers with those

[23] As it did in this case, PBGC may involuntarily terminate a plan to limit its own mounting losses when contributions are not being made. *See* 29 U.S.C. § 1342(a)(1) and (4). But plan termination often has adverse consequences for participants, the employer, and the agency.

funding standards. Granting priority in bankruptcy for the excise tax on missed contributions will strengthen that protection.

CONCLUSION

The decision of the court of appeals should be reversed. The section 4971(a) tax should be accorded priority as an excise tax under section 507(a)(7)(E) of the Bankruptcy Code. It should not be subordinated to the claims of other creditors.

Respectfully submitted,

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Dated: January 16, 1996

No. 95-325

(6)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA,
Petitioner,

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC., *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE AND* BRIEF FOR THE UNITED STEELWORKERS OF AMERICA, AFL-CIO, AS *AMICUS CURIAE* SUPPORTING RESPONDENTS

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MOTION BY THE UNITED STEELWORKERS OF AMERICA, AFL-CIO-CLC, FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* SUPPORTING RESPONDENTS

The United Steelworkers of America, AFL-CIO-CLC ("USWA"), hereby moves for leave to file the accompanying brief *amicus curiae* in support of the position of the respondents in the instant case.

The USWA is an international labor organization with over 650,000 members who are employed in steel and other industries. For decades, the USWA served as the collective bargaining representative of the vast majority of the employees of the steel subsidiary of CF&I Corporation ("CF&I") at the company's steel plant and rail mill in Pueblo, Colorado. In that capacity, the USWA negotiated with CF&I over many years to establish and maintain comprehensive pension and health insurance programs enabling CF&I employees to earn vital retirement benefits.

In 1990, CF&I and its subsidiaries sought relief under chapter 11 of the Bankruptcy Code. The USWA played a significant role in the bankruptcy reorganization case. The USWA's efforts were aimed at preserving jobs and the employment-related benefits of employees and retirees. The USWA acted as the exclusive collective bargaining representative of most CF&I employees, served on the officialy committee of unsecured creditors appointed pursuant to 11 U.S.C. Section 1102(a)(1), and negotiated a new collective bargaining agreement with the purchaser of most of CF&I assets, an agreement which served as an important foundation for the CF&I reorganization. Finally, the USWA served as the "authorized representative" of CF&I's retirees and their surviving spouses in negotiations over their right to life-time retiree medical benefits. *See* 11 U.S.C. Section 1114(b)(1).

Beyond the CF&I bankruptcy, the restructuring of the steel industry since the mid-1980's has required the USWA to represent the interests of tens of thousands of employees and retirees facing loss of their livelihood and

employment-based benefits in similar reorganization proceedings. The USWA played a major and unique role in the chapter 11 cases of such companies as LTV, Wheeling-Pittsburgh Steel, Sharon Steel, Kaiser Steel and Copperweld Steel.

As the "authorized representative" of most CF&I retirees and their surviving spouses pursuant to Section 1114, the USWA negotiated as part of a plan of reorganization the creation and funding of a Voluntary Employee Benefit Association ("VEBA") pursuant to Section 501(c)(9) of the Internal Revenue Code ("IRC"), which settled unsecured claims for future benefits for retirees. The VEBA provides ongoing medical benefits for retirees and their dependents. The purchaser was unwilling to assume responsibility for these benefits other than through an allocation of part of the purchase price to the VEBA. While retiree benefits were reduced, the VEBA permitted continuation of vital health coverage for CF&I retirees and their dependents.

With the cooperation and active participation of the USWA, the CF&I bankruptcy was successful in reorganizing a steel busines for the benefit of employees, retirees, creditors, customers, and the economically depressed community of Pueblo, Colorado. The reorganization was achieved notwithstanding, among other obstacles, adverse industry conditions, CF&I's limited ability to continue operating in the absence of an investor or purchaser, a dearth of potential investors or purchasers, the requirement to achieve some recovery for unsecured creditors, and the human needs of employees to retain their jobs and of retirees to continue a basic lifeline to medical benefits. CF&I's reorganization was a success that exemplified the "fundamental purpose of reorganization," which is to "prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources." *NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 528 (1984).

CF&I's reorganization was possible only because the bankruptcy court rejected penalty claims filed by the Internal Revenue Service ("IRS"). *See In re CF&I Fabricators, Inc.*, 148 B.R. 332 (Bankr. D. Utah 1992) (pet. 38a-62a). The bankruptcy court found that the IRS's 10 percent "first tier" nonpecuniary loss penalty claim under 26 U.S.C. § 4971(a) (imposed for CF&I's failure to make contributions to its pension plan), and the IRS's 100 percent "second tier nonpecuniary loss penalty claim under 26 U.S.C. § 4971(b) (imposed on a cumulative basis for CF&I's continuing failure to correct the delinquency), were not entitled to excise tax priority under the Bankruptcy Code, 11 U.S.C. § 507 (a)(7)(E). *Id.* at 337-40, pet. 46a-52a. The bankruptcy court found that assigning such a priority would have doomed any chance for reorganization, resulting in a total loss to all other interested parties. *Id.* at 339, pet. 51a. In subsequent appeals the IRS, presumably for tactical reasons, abandoned its second tier penalty claims.

The IRS's assertion of priority for its claims is of grave concern to the USWA as a chapter 11 creditor, collective bargaining representative, and authorized representative of retirees. Because of the Bankruptcy Code's overall emphasis on "equality of distribution" to creditors, *Begier* v. *IRS*, 496 U.S. 53, 58 (1990), priorities are interpreted strictly, *United States* v. *Embassy Restaurant, Inc.*, 359 U.S. 29, 31 (1959). Assigning excise tax priority to the 10 percent nonpecuniary loss penalty at issue in this case and, by necessary logic, to the similar 100 percent nonpecuniary loss penalty, would undermine this Court's long-standing decisions that Bankruptcy Code provisions must be interpreted consistent with the overall structure and goals of the Bankruptcy Code, and specifically so when interpreting bankruptcy provisions involving taxes. *City of New York* v. *Feiring*, 313 U.S. 283, 285 (1941). Because this Court has held that many of the rights of workers and retirees under a collective bargaining agreement, and as creditors in a chapter 11 proceeding, are ultimately dependent on the provisions of the Bankruptcy Code, *Embassy Restaurant*, 359 U.S. 31;

Bildisco, 465 U.S. 513, labor unions have a strong interest in consistent interpretation of the Bankruptcy Code.

In almost all chapter 11 bankruptcies, including the CF&I case, the estate has insufficient assets to pay creditors in full—or even a significant portion of their claims. Indeed, many chapter 11 bankruptcies ultimately result in liquidation because there are insufficient assets for a debtor to reorganize and remain an operating concern. Assigning the IRS an excise tax priority would elevate the IRS's nonpecuniary penalty loss claims at the expense of almost all other constituencies and ultimately the reorganization process itself, a result at odds with Congress's purpose in enacting the Bankruptcy Code.

The PBGC, appearing as *amicus curiae* in support of the IRS, does not discuss the impact of this case on reorganizations. The PBGC does state that it has little concern about how "its recovery in this case" will be affected by assigning priority to the IRS's claims because the PBGC's "financial health will not be greatly affected" by the amount of the recovery. The PBGC also posits that the courts below inappropriately concluded that granting the IRS a tax priority would negatively affect CF&I retirees in their capacity as pension plan participants. PBGC Br. at 22-23.

The USWA does not have the luxury of the PBGC's perspective, and it respectfully disagrees with the PBGC's notions concerning the interest of retirees. The USWA was concerned about a successful reorganization and the creation of a viable VEBA because the physical health of CF&I retirees, and the economic survival of employees, was at stake. The outcome of this case will have a major impact on the health of retirees, the economic survival of employees, and the success of reorganizations in many other chapter 11 bankruptcies. The USWA, and not the parties or PBGC as *amicus curiae*, can present these perspectives, facts, and legal implications. Thus, the USWA has an interest as *amicus curiae* in support of the respondents on the question of the priority of the IRS's nonpecuniary loss penalty claims.

CONCLUSION

For the above stated reasons, this motion for leave to file a brief *amicus curiae* should be granted.*

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* Counsel for USWA has received consent of the respondents to file the accompanying Brief *amicus curiae*. Counsel for the USWA has not had opportunity to contact counsel for the United States.

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Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

---

BRIEF FOR THE UNITED STEELWORKERS OF AMERICA, AFL-CIO-CLC, AS *AMICUS CURIAE* SUPPORTING RESPONDENTS

INTEREST OF THE *AMICUS CURIAE*

The brief of *amicus curiae* is filed contingent on the granting of the foregoing motion for leave to file said brief. The interest of the USWA is set forth in that motion.

SUMMARY OF ARGUMENT

The issue in this case is whether IRS claims against employers who fail to make required contributions to their pension plans are treated as taxes or penalties for purposes of priority treatment under the Bankruptcy Code. This Court held that under the Bankruptcy Act, the predecessor to the Bankruptcy Code, the status of a federal or state assessment as a task or penalty was determined by the nature of the assessment. There was no definition of "tax" in the Act, as there is no definition of "tax" in the Bankruptcy Code. Congress did not in-

tend to change the established judicial tax/penalty analysis when it enacted the Bankruptcy Code.

There is no dispute that IRS's first tier penalty is a penalty, not an excise tax, under this Court's decisions construing the Bankruptcy Act and lower court decisions interpreting the Bankruptcy Code. *CF&I*, 148 B.R. at 338, pet. 47a. Congress created claims under Section 4971 of the IRC in order to penalize employers who fail to make required pension contributions. All sums collected by the IRS pursuant to its penalty go directly to the general treasury of the United States; no part of the recovery is utilized to fund pension benefits or compensate the PBGC for a monetary loss.

There is also no dispute that, if the Bankruptcy Code's excise tax priority is applicable to the 10 percent penalty (which in this case amounts to approximately $1.2 million), it would be equally applicable to the cumulative 10 and 100 percent penalties, totalling approximately $41.8 million, which the IRS chose not to pursue on appeal. *Id.* at 337, pet. 44a-45a. Despite the IRS's abandonment of its second tier penalty claim in this proceeding, this Court's decision will clearly influence the treatment of such second tier penalty claims, and reorganization efforts, in future cases.

Application of the tax/penalty analysis to the IRS's penalty claims is also consistent with the overriding congressional intent of promoting reorganization of companies, with the attendant saving of jobs and employee benefits, through chapter 11 of the Bankruptcy Code.

While the IRS's request for bankruptcy priority treatment of its claim is based on descriptive labels in the IRC, the courts below correctly held that the established judicial tax/penalty principles are applicable and the IRS acknowledged that its claims are not taxes under that analysis. The decision of the court below should be affirmed.[1]

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[1] **The USWA takes no position on the bankruptcy court's equitable subordination of the IRS's claims.**

ARGUMENT

I. THE IRS IS NOT ENTITLED TO PRIORITY TREATMENT FOR ITS CLAIM PURSUANT TO SECTION 4971 OF THE IRC BECAUSE SECTION 4971 IMPOSES A PENALTY, NOT AN "EXCISE TAX," WITHIN THE MEANING OF SECTION 507(a)(7)(E) OF THE BANKRUPTCY CODE.

A. In Applying Bankruptcy Priorities, This Court Has Consistently Distinguished Between "Taxes" and "Penalties" Based on the Purpose and Nature of the Claim.

In interpreting provisions of the Bankruptcy Code, this Court begins with the statutory language. *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 557-58 (1990); *Kelly* v. *Robnison*, 479 U.S. 36, 43 (1986). Section 507(a) of the Bankruptcy Code provides priority treatment for certain "excise taxes," as follows:

> (a) The following expenses and claims have priority in the following order:
>
> * * *
>
> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—
>
> * * *
>
> (E) *an excise tax on*—
>
> (i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or
>
> (ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition.

11 U.S.C. § 507(a) (West 1993) (emphasis added).

Congress did not define the terms "tax" and "excise tax" in the Bankruptcy Code or by reference to a definition in another statute, nor did it do so in the predecessor Bankruptcy Act. To advance well-defined policies underlying federal bankruptcy law, this Court consistently applied a functional definition of "taxes" entitled to priority treatment in Section 64 of the Bankruptcy Act. Pursuant to this definition, "taxes" are limited to "those pecuniary burdens laid upon individuals or their property, regardless of their consent, for the purpose of defraying the expenses of government or of undertakings authorized by it." *Feiring*, 313 U.S. at 285; *New Jersey* v. *Anderson*, 203 U.S. 483, 492 (1906); *United States* v. *New York*, 315 U.S. 510, 515-16 (1942).

In applying this definition, this Court concluded that an assessment that serves to promote other purposes, such as to penalize undesirable conduct, would not be a "tax" for purposes of bankruptcy legislation even when the assessment was labeled a tax in the relevant nonbankruptcy statute. *Feiring*, 313 U.S. at 285 (status of claim as a "tax" within the meaning of Section 64 of the Bankruptcy Act does not depend on whether the obligation has been denominated a "tax" in a nonbankruptcy statute but, rather, on "whether its incidents are such as to constitute a tax within the meaning of § 64"); *New Jersey*, 203 U.S. at 491 (whether claim is a tax within the meaning of Section 64 of the Bankruptcy Act is a question for the federal courts).

This Court applied the tax/penalty functional analysis where, as here, an assessment was denominated an "excise tax" in a federal statute. *United States* v. *New York*, 315 U.S. at 515-16 (pecuniary burden imposed by Congress that satisfies functional definition constitutes a tax "by whatever name it may be called"); [2] *cf. Simonson* v. *Granquist*, 369 U.S. 38, 42 (1962) ("the character of a [federal tax] penalty is by no means changed by calling it a lien"); *United States* v. *Sotelo*, 436 U.S. 268, 275 (1978) ("That the funds due are referred to as a 'penalty' when the Government later seeks to recover them does not alter their essential character as taxes for the purposes of the Bankruptcy Act").

[2] The Brief of the United States does not analyze or mention this Court's decision in *United States* v. *New York*.

This Court's approach in defining "taxes" and "penalties" on the basis of the purpose and nature of the exaction involved derives from fundamental bankruptcy purposes and principles, *see, e.g., Feiring*, 313 U.S. at 285, particularly the two core principles that (i) priorities are to be narrowly construed, *Embassy Restaurant*, 359 U.S. at 31 ("if one claimant is to be preferred over others, the purpose should be clear from the statute") (quoting *Nathanson* v. *NLRB*, 344 U.S. 25, 29 (1952)); *In re Amarex, Inc.*, 853 F.2d 1526, 1530 (10th Cir. 1988); *Trustees of the Amalgamated Ins. Fund* v. *McFarlin's Inc.*, 789 F.2d 98, 100 (2d Cir. 1986); and (ii) penalties are disfavored to avoid harming innocent creditors. As explained by this Court in *Simonson* v. *Granquist*, the prohibition on recovery for penalties

> is in keeping with the broad aim of the Act to provide for the conservation of the estates of insolvents to the end that there may be as equitable a distribution of assets as is consistent with the type of claim involved. . . . Enforcement of penalties against the estates of bankrupts . . . would serve not to punish the delinquent taxpayers, but rather their entirely innocent creditors.

369 U.S. at 40-41. This approach mandates affirmance of the decisions below.

B. The IRS's Claims Under Section 4971 of the IRC Are Penalties, Not "Taxes," Within the Meaning of Section 507(a)(7)(E) of the Bankruptcy Code.

1. The IRS's claims are "penalties" and not "taxes" under this Court's settled tax/penalty analysis for review-

ing bankruptcy priorities. The legislative history demonstrates that Congress intended Section 4971 to serve as a penalty and not to defray the expenses of government. *See* H.R. Rep. No. 807, 93rd Cong., 2d Sess., reprinted in 1974 U.S.C.C.A.N. 4670, 4694 ("the committee bill places the . . . *penalty* for underfunding on the person on whom it belongs—namely the employer") (emphasis added); S. Rep. No. 383, 93rd Cong., 2d Sess., reprinted in 1974 U.S.C.C.A.N. 4890, 4909 (same).

Two circuit courts of appeals, applying these principles, held that similar claims based on the assessment contained in Section 4941 of the IRC, which is labeled a "tax" and contained within the IRC subtitle entitled "miscellaneous excise taxes," imposed a penalty and were not entitled to priority "tax" treatment under the Bankruptcy Act. *See In re Unified Control Sys., Inc.*, 586 F.2d 1036, 1037-38 (5th Cir. 1978) (per curiam); *In re Joel Kline*, 547 F.2d 823 (4th Cir. 1977) (per curiam), *aff'g*, 403 F. Supp. 974 (D. Md. 1975).

In interpreting provisions of the Bankruptcy Code, this Court has instructed that established judicial interpretations of the Bankruptcy Act continue to apply absent clear indication that Congress intended a change when it enacted the Bankruptcy Code. *Midlantic Nat'l Bank* v. *New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986) ("The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. . . . The Court has followed this rule with particular care in construing the scope of bankruptcy codifications") (citation omitted); *Kelly*, 479 U.S. at 47, 53; *Dewsnup* v. *Timm*, 502 U.S. 410, 418-20 (1992).

As demonstrated above, Congress did not write "on a clean slate," *id.* at 417, when it established priorities for "taxes" in the Bankruptcy Code. Indeed, there is no evidence in the legislative history of the Bankruptcy Code

that Congress intended to discard the established judicial definition of "taxes" eligible for priority treatment under federal bankruptcy laws. Thus, courts have continued to apply the principles set forth in *United States* v. *New York*, *Feiring*, and *New Jersey* to distinguish taxes from penalties under the Bankruptcy Code. *See, e.g., In re Cassidy*, 983 F.2d 161 (10th Cir. 1992) (claim arising from exaction under Section 72(t) of the IRC for premature withdrawal of pension funds constitutes a penalty for nonpecuniary loss not entitled to tax priority under Section 507(a)(7) of the Bankruptcy Code); *In re C-T, Inc.*, 977 F.2d 137 (4th Cir. 1992) (claim arising from retirement plan taxes pursuant to Section 4980 of the IRC found to have substantially more attributes of an excise tax than a penalty, and entitled to priority treatment), *cert. denied*, 507 U.S. 1004 (1993).

Moreover, all but one court that has considered the issue has held that the IRS's assessments pursuant to Section 4971 impose a penalty on employers who underfund their pension plans and, therefore, are not claims for "taxes" or "excise taxes" within the meaning of Section 507(a)(7)(E) of the Bankruptcy Code. *See In re CF&I Fabricators, Inc.*, 148 B.R. 332, pet. 38a-62a (Bankr. D. Utah 1992), *aff'd in unpublished opinion, see* Pet. 10a-11a, *aff'd*. 53 F.3d 1155, pet. 1a-9a (10th Cir. 1995); *In re Chateaugay Corp.*, 15 Empl. Ben. Cas. (BNA) 1237 (Bankr. S.D.N.Y.), *rev'd on other grounds*, 146 B.R. 626 (S.D.N.Y. 1992), *vacated on onsent of the parties*, 157 B.R. 74 (S.D.N.Y. 1993); *In re Airlift Int'l, Inc.*, 120 B.R. 597, 601 (S.D. Fla. 1990); *In re Wheeling-Pittsburgh Steel Corp.*, 103 B.R. 672, 693 (Bankr. W.D. Pa. 1989); *In re Bertsch & Co.*, No. IP84-8366RA J, 1988 Bankr. LEXIS 2570 (Bankr. S.D. Ind. Aug. 15, 1988). *But see In re Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (6th Cir. 1991), *rev'g*, 120 B.R. 862 (N.D. Ohio 1990), *aff'g*, 80 B.R. 395 (Bankr. N.D. Ohio 1987), *cert. denied*, 502 U.S. 1092 (1992).

2. The IRS contends that what it deems a "plain text" reading of Section 507(a)(7)(E) establishes that Congress intended a change in the definition of tax claims when it enacted the Bankruptcy Code. The IRS argues that an assessment labeled an "excise tax" by Congress in any federal statute must necessarily constitute an "excise tax" for purposes of Section 507(a)(7)(E) of the Bankruptcy Code.

The IRS's "plain text" argument is not a plain meaning argument, and should be deemed a "consistent meaning" argument. This argument is without support in this Court's decisions, which have repeatedly held that identical terms may have different meanings in different federal statutes. As emphasized in *Atlantic Cleaners & Dyers, Inc.* v. *United States*, 286 U.S. 427, 433 (1932):

> Most words have different shades of meaning, and consequently may be variously construed, not only when they appear in different statutes, but when used more than once in the same statute or even in the same section. . . . It is not unusual for the same word to be used with different meanings in the same act, and there is no rule of statutory construction which precludes the courts from giving to the word the meaning to which the Legislature intended it should have in each instance.

See also Director, OWCP v. *Perini N. River Assocs.*, 459 U.S. 297, 320 n.29 (1983) (the term "maritime" has different meanings in 28 U.S.C. § 1331(1) and in § 2(3) of the Longshoremen's and Harbor Workers' Compensation Act); *District of Columbia* v. *Carter*, 409 U.S. 418, 420 (1973) ("Whether the District of Columbia constitutes a State or Territory within the meaning of any particular statutory or constitutional provision depends upon the character and aim of the specific provision involved"); *Puerto Rico* v. *Shell Co.*, 302 U.S. 253, 258-59 (1937) ("although Puerto Rico is not a territory within the reach of the Sixth and Seventh Amendments and may not be a 'territory' within the meaning of the word as used in some

statutes . . . there is no reason why Puerto Rico should not be held to be a 'territory' within the meaning of section 3 of the Sherman Act"); Cook, *"Substance" and "Procedure" in the Conflict of Laws*, 42 Yale L.J. 333, 337 (1933) ("The tendency to assume that a word which appears in two or more legal rules, and so in connection with more than one purpose, has and should have precisely the same scope in all of them, runs all through legal discussions. It has all the tenacity of original sin and must constantly be guarded against.").[3]

Moreover, the IRS's argument for cross-statutory consistent meaning puts words in the mouth of Congress that do not appear in the Bankruptcy Code. Congress said that a seventh priority would be afforded for "excise taxes," not "for excise taxes as denominated in the IRC." In many other provisions of the Bankruptcy Code, Congress did define terms by reference to specific provisions of other statutes. For example, within Section 507, the same priority section at issue here, Congress provided a first priority for "fees and charges assessed against the estate under chapter 123 of title 28." 11 U.S.C. § 507(a)(1). Indeed, other provisions of the Bankruptcy Code define terms contained therein by specific reference to terms and provisions contained in the IRC. *See, e.g.*, 11 U.S.C. § 101(41)(C)(i) (West Supp. 1995) ("employee pension benefit plan that is a governmental plan, as defined in section 414(d) of the Internal Revenue Code of 1986"); 11 U.S.C. § 101(41)(C)(ii) (West Supp.

[3] Indeed, the definiiton of a term in the Bankruptcy Code, or any other individual statute, is not necessarily internally consistent. *See, e.g.*, *Dewsnup*, 502 U.S. at 417 n.3 (particularly in light of the pre-Code rule, the words "allowed secured claim" have a different meaning in two subsections of the same section of the Bankruptcy Code); *see also Concrete Pipe and Prods., Inc.* v. *Construction Laborers Pension Trust*, 113 S. Ct. 2264, 2285 (1993) (term "unreasonable" given different meaning in different sections of Multiemployer Pension Plan Amendments Act); *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 86-87 (1934) (term "obligations" has different meaning in different parts of federal tax law).

1995) ("eligible defined compensation plan, as defined in section 457(b) of the Internal Revenue Code of 1986"); *see also* 11 U.S.C. § 346(g)(1)(c) (West Supp. 1995) (reference to transfers resulting in gain or loss under IRC section 371); 11 U.S.C. § 522(d)(10)(E)(iii) (West Supp. 1995) (reference to non-qualifying payments under IRC sections 401(a), 403(a), 403(b), or 408); 11 U.S.C. § 724(d) (West Supp. 1995) (reference to tax liens under IRC section 6323).

Congress's failure to refer to the IRC to define the term "tax" or "excise tax" in Section 507 demonstrates that Congress intended courts to look beyond the labels of the IRC and to continue this Court's settled interpretation of the term "taxes" under the Bankruptcy Act. *BFP* v. *Resolution Trust Corp.*, 114 S. Ct. 1757, 1761 (1994) ("[I]t is generally presumed that Congress acts intentionally and purposely when it included particular language in one section of a statute but omits it in another") (quoting *Chicago* v. *Environmental Defense Fund*, 114 S. Ct. 1588, 1593 (1994)).

Finally, the IRS does not advocate a consistent approach. The IRS asserts, without authority, that bankruptcy courts may not look beyond the labels on assessments enacted by Congress but may do so for state-enacted assessments. IRS Br. at 20 n.11. A federal entity asserting a claim based on a penalty designated an "excise tax" by Congress would receive a priority claim, while a state entity asserting a claim based upon a similar penalty designated an "excise tax" by a state legislature would receive only a general unsecured claim. There is simply no textual or principled policy basis for such a result. *Cf. Patterson* v. *Shumate*, 504 U.S. 753, 758-59 (1992) (Congress's use of term "applicable nonbankruptcy law" not limited to state law). Nothing in the Bankruptcy Code, or specifically Section 507, suggests any grounds to distinguish between the federal and state governments in their capacities as claimants seeking

priority treatment of claims as "taxes" under Section 507(a)(7)(E). *CF&I*, 148 B.R. at 339, pet. 51a. Indeed, given the absence of statutory language or evidence of a legislative purpose to distinguish between the federal and state governments as creditors, the IRS's proposed construction would violate the principle of equality of treatment of similarly-situated creditors. *See, e.g., Begier* v. *IRS*, 496 U.S. 53, 58 (1990); *United States* v. *Embassy Restaurant, Inc.*, 359 U.S. 29, 31 (1959); *Nathanson* v. *NLRB*, 344 U.S. 25, 29 (1952).

3. As labor organizations well know, this Court has held that the established definition of a term in federal labor laws may not be applicable in a bankruptcy context if that definition is inconsistent with the bankruptcy statute. *Embassy Restaurant*, 359 U.S. 29; *Joint Industry Bd. of the Elec. Indus.* v. *United States*, 391 U.S. 224 (1968). *Cf. Morrison-Knudsen Constr. Co.* v. *Director, OWCP*, 461 U.S. 624 (1983) (employer contributions to union trust funds are not "wages" for purposes of Section 2(13) of the Longshoremen's and Harbor Workers Compensation Act); *Alabama Power Co.* v. *Davis*, 431 U.S. 581, 592 n.16 (1977) ("Even if pensions are 'wages' for the purposes of the [National Labor Relations Act], their classification would not control their treatment under the [Military Service Act of 1967]").

In *Embassy Restaurant*, a union welfare fund asserted that its claim for unpaid contributions by the debtor/employer, owed to the fund for each full-time employee pursuant to a collective bargaining agreement, was entitled to the priority status afforded claims for "wages . . . due to workmen" under Section 64(a)(2) of the Bankruptcy Act. 359 U.S. at 29-30. The Fund relied on the established construction of the term "wages" under the National Labor Relations Act and the Social Security Act to include welfare fund contributions in attempting to fit its claim within a category warranting priority treatment. *Id.* at 33-34.

Rather than adopt the definitions of other federal statutes, the Court found this evidence inapposite, stating, "*We construe the priority section of the Bankruptcy Act, not those statutes.*" *Id.* at 33 (emphasis added). To do so, it was necessary to "examine the nature of these contributions." *Id.* at 32. The Court found that the contributions owed were not "due to workmen" and lacked "the customary attributes of wages." *Id.* at 33. Moreover, because the contributions were paid to the Fund, and not to the workers, affording the claim priority status would not have advanced Congress's purpose in establishing the priority to provide workers a "protective cushion" against the economic displacement caused by the employer's bankruptcy. *Id.* Finally, the Court noted that if the Fund's claims were treated on a par with wages, workers' recoveries might be diminished, thus frustrating Congress's purpose. *Id.* at 33-34.

Nine years later, in *Joint Industry Board*, the Court adhered to its holding and approach in *Embassy Restaurant*. *Joint Industry Board* involved unpaid employer contributions to an employees' annuity plan established under a collective bargaining agreement. 391 U.S. at 225. Although the annuities were

> (1) . . . to be paid as part of the wage bargain between employer and employee; (2) . . . the sum due each employee was specifically related to and measured by his work; (3) . . . the sum which each employee earned was accounted for separately and individually; he was entitled to the amount paid to the trustee on account of his individual labor; and (4) . . . inevitably, as sure as death, there was to come a point of time when the sum remitted to the trustee on account of each individual's work would be paid to that individual or his heirs[,]

id. at 230 (Fortas, J., dissenting), the Court still rejected the position that annuity contributions constituted "wages" within the meaning of the Bankruptcy Act. *Id.* at 226-29. The Court again noted that the contributions

did not "*satisfy the fundamental purpose of the . . . priority for wages due to workmen*," *id.* at 228 (emphasis added), and that permitting priority status would reduce the amounts payable to workers. *Id.* at 228-29.

4. There is no principled basis for the Court not to follow its dictate in *Embassy Restaurant* in this case to "examine the nature of these [claims]." The IRS's claim, as the IRS concedes, is in the nature of a penalty. To afford a penalty claim priority treatment will subvert Congress's purpose in enacting the Bankruptcy Code to promote successful reorganizaiton of debtors, and will harm those parties for whose benefit Congress enacted Section 4971.

In the courts below, the IRS acknowledged that it relied on the label of excise taxes within the IRS covering § 4971, and that it cannot prevail if this Court's traditional definition of "taxes" continues to apply. *CF&I*, 148 B.R. at 338, pet. 48a-49a ("The IRS agreed that if the court employed such a test it would not be able to sustain the position that the section 4971 excise taxes are not penalties because it could not meet the third prong of the [*In re*] *Lorber Industries* [675 F.2d 1062, 1066 (9th Cir. 1982)] test," *i.e.*, that the exacation be "[f]or public purposes, including the purpose of defraying expenses of government or undertakings authorized by it").

While the IRS's concession negates any need for this Court to analyze the nature of the IRS's claims, even a cursory tax/penalty analysis demonstrates that the IRS's claims are penalties, and that recognition of such a priority would be wholly inconsistent with overriding bankruptcy reorganization objectives.

The Bankruptcy Court held that affording the IRS's claims priority treatment "would defeat any attempt by the Debtors to reorganize." *CF&I*, 148 B.R. at 339, pet. 51a. Such a result, of course, would directly contravene the fundamental policy of chapter 11 "to permit successful rehabilitation of debtors" and "to prevent a debtor

from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources." *Bildisco*, 465 U.S. at 527, 528.

This result would not be isolated to CF&I. For example, in the LTV bankruptcy, the bankruptcy court remarked that the IRS's claim, if allowed as a priority claim, could preclude succesful reorganization, resulting in a "castastrophe for all involved." *Chateaugay Corp.*, 15 Empl. Ben. Cas. (BNA) at 1238. The USWA, with its extensive experience in bankruptcy reorganizations, believes that adoption of the IRS's position would threaten the potential for reorganization in numerous cases, with concomitant loss to all who depend on a successful chapter 11 process.

Applying this Court's longstanding tax/penalty distinction to the IRS's claims also gives effect to the core bankruptcy policies which mandate equality of treatment of similarly situated creditors, *see supra* pp. 10-11 and disfavor penalties, *see supra* p. 5.

The legislative history of Section 4971 demonstrates that Congress intended to punish employers who underfund their pension plans, but not to punish pensioners or the PBGC. *See, e.g.*, *CF&I*, 148 B.R. at 338 n.9, pet. 47a (quoting legislative history); *Chateaugay Corp.*, 15 Empl. Ben. Cas. (BNA) at 1238. Providing priority treatment to the IRS's penalty claims, however, will "harm the parties that are intended to be protected by the pension plan that section 4971 seeks to enforce, because payment of section 4971 penalty claims would be at the expense of prepetition unsecured creditors including pensioners." *C&FI*, 148 B.R. at 339, pet. 51a; *Airlift Int'l*, 120 B.R. at 601-02. In enacting the Bankruptcy Code, Congress clearly did not modify *sub silentio* the traditional tax/penalty distinction, a modification which would harm the employees and retirees represented by the USWA and defeat the very purpose of chapter 11 of the Bankruptcy Code—reorganization.

CONCLUSION

For the reasons stated herein, the Court of Appeals' holding that the IRS's penalty claim is not entitled to a seventh priority should be affirmed.

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